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Supreme Court, U.S.
FILED

OCT 30 2008

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No. 08-838

In The Supreme Court of the United States

NAVEEN JAIN AND ANURADHA JAIN,
Petitioners,

v.

J.P. MORGAN SECURITIES, INC.,
WILSON SONSINI GOODRICH & ROSATI, P.C.,
AND PERKINS COIE, LLP,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE COURT OF APPEALS
FOR THE STATE OF WASHINGTON

PETITION FOR A WRIT OF CERTIORARI

Arthur W. Harrigan, Jr.
Counsel of Record
Timothy G. Leyh
Christopher T. Wion
DANIELSON HARRIGAN LEYH & TOLLEFSON LLP
999 Third Avenue, Suite 4400
Seattle, Washington 98104
Telephone: (206) 623-1700
Facsimile: (206) 623-8717

Robert B. Gould
LAW OFFICES
2110 North Pacific Street, Suite 100
Seattle, Washington 98103
Telephone: (206) 633-4442
Facsimile: (206) 633-4443

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QUESTION PRESENTED

Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p(b)) ("16(b)") imposes "strict-liability" on insiders who engage in "short-swing" trades of company securities. The Jains were found strictly liable under 16(b). After satisfying their 16(b) liability to the issuer, they sued to recover their losses to the extent they were the result of Respondents' negligence. Below, the Court of Appeals affirmed dismissal of the Jains' state law claims, holding they were barred, as a matter of law, by a federal policy against "de facto indemnification" for liability imposed by the federal securities laws.

The question presented is:

Whether securities professionals can escape liability for their clients' losses on federal policy grounds where the objectives of the securities statute under which their clients' loss occurred were satisfied and the professionals' negligence caused those losses.

PARTIES TO THE PROCEEDING

Petitioners are Naveen and Anuradha Jain, a married couple. They were plaintiffs in Superior Court, and appellants in both the Court of Appeals and Supreme Court for the state of Washington.

Respondents are J.P. Morgan Securities, Inc., Wilson Sonsini Goodrich & Rosati, P.C., and Perkins Coie, LLP. They were defendants in Superior Court and respondents in both the Court of Appeals and Supreme Court for the state of Washington.

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PETITION FOR WRIT OF CERTIORARI

The Jains respectfully petition the Court for a writ of certiorari to the Washington State Court of Appeals (review denied by the Washington State Supreme Court). That court held that a federal policy against "de facto indemnity" immunized securities professionals from liability to their client where their negligent conduct created the very transactions that led to the Jains' strict liability for "short-swing" trading under Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p(b)) ("16(b)"), and immunized the lawyers whose negligence and conflicts of interest resulted in a ruling of 16(b) liability. The Jains were unaware of the short-swing transactions, had settled the 16(b) judgment by paying the issuer, and sought only to allocate their losses according to fault under well-recognized principles of state law.

OPINION BELOW

The decision of the Washington State Court of Appeals (App. B) for which this Petition is filed is reported at 177 P.3d 117 (Wash. Ct. App. 2008).

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1257, which provides that "Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court by writ of certiorari where the validity of a treaty or statute of the United States is drawn in question[.]" On October 1, 2008, the Washington State Supreme Court issued

an order (App. A) denying Petitioners' Petition for Review, rendering the Court of Appeals' January 14, 2008 order (App. B) a "final judgment" rendered by the highest Washington State court "in which a decision could be had." This Petition is timely under 28 U.S.C. § 2101 and Supreme Court Rule 13.1.

STATUTORY PROVISION INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), states:

> **Profits from purchase and sale of security within six months**
> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involving any such equity security within any period of less than six months, unless such security or security-based swap agreement was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security or

security-based swap agreement purchased or of not repurchasing the security or security-based swap agreement sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security or security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

STATEMENT OF THE CASE

Petitioners request that this Court grant a writ of certiorari to review a decision of the Washington State Court of Appeals.

This case raises unsettled issues of the extent to which negligent securities professionals are protected, by a federal policy against "de facto indemnity," from liability they would otherwise have under state law for losses their client suffered. The Circuits are divided on whether and to what extent the Securities Exchange Act of 1934 (the "1934 Act") bars such actions. Specifically, this case presents the question whether securities professionals whose negligence a) created short-swing trades and b) in one case created the appearance of a short-swing trade that did not actually occur, are immunized from liability by a federal "anti-indemnity" rule where the insider held liable for such trades under Section 16(b) of the 1934 Act (15 U.S.C. § 78p(b)) was not even aware of the actions that created the transactions or of the false statements that created the appearance of a transaction that did not occur. While this case arises under 16(b), the "de facto indemnity" issue has also frequently arisen under other provisions of the 1934 Act and the Securities Act of 1933 (the "1933 Act"). This Court has not ruled on the existence or scope of such a bar to state law claims, and the Circuits are divided.

I. Factual Background

A. The Parties

The Jains founded InfoSpace, Inc. in 1996 and received "Founders" shares of InfoSpace stock at that time. Later, they established three trusts to benefit their children, and funded them with InfoSpace stock.

InfoSpace completed its IPO in December 1998. Respondents J.P Morgan Securities, Inc. ("Morgan"), Wilson Sonsini Goodrich & Rosati, P.C. ("Wilson"), and Perkins Coie LLP ("Perkins") were responsible for preparing the IPO Prospectus as lead underwriter, counsel for the underwriter, and counsel for InfoSpace, respectively. Morgan also was the Jains' personal securities broker. Respondents each took actions that, individually or collectively, created "purchases" by the Jains of the trusts' InfoSpace shares or the appearance of such purchases – by misdepositing trust shares into the Jains' personal investment account and by inserting into the IPO Prospectus a footnote containing a false statement regarding creation of an escrow with trust shares, as discussed below.

Years after the IPO, a shareholder sued the Jains for "short-swing" trading under 16(b), based on sales by the Jains of some of their Founders' shares within six months after "purchases" that were held to have occurred by reason of the false footnote and misdeposits. The Jains were unaware of the misdeposits. The footnote described an event that never actually occurred. In the 16(b) litigation, Perkins represented the Jains as defense counsel. Perkins had conflicts both because it also represented InfoSpace (the direct beneficiary of any judgment against the Jains) in other matters and because it was a co-author of the false footnote and should have been an important witness on the Jains' behalf.

B. The Securities Transactions at Issue in the 16(b) Litigation

1. The False Footnote in the InfoSpace IPO Prospectus.

Prior to the IPO, Mr. Jain agreed to place one million of his InfoSpace shares in escrow to secure a personal indemnity obligation. On the eve of the IPO, Wilson and Perkins added a footnote to the 115-page Prospectus stating that Mr. Jain had placed in escrow one million shares owned by one of the trusts. No such event occurred. Mr. Jain was not aware of the footnote when he signed the Prospectus as an InfoSpace Director responsible only for avoiding misstatements material to investors. As Respondents actually contended below, the footnote was false, no such escrow ever was established, and the District Court's ruling to the contrary in the 16(b) action was incorrect.

2. The Misdeposits of Trust Shares into the Jains' Personal Account.

After the IPO, InfoSpace stock split. Both the Jains and each of their children's trusts received additional shares. InfoSpace sent all of the share certificates to the Jains; the trusts' certificates should have been sent to the Trustee. The Jains forwarded all of the certificates to their broker, Morgan, which was also slated to become the trusts' broker. Morgan negligently deposited all of the shares – including the trust shares – into the Jains' personal account. At Morgan's request, Wilson (acting as InfoSpace's counsel) authorized re-registering the trust shares to the Jains, falsely

stating in a letter to InfoSpace that the Jains (not the trusts) already owned those shares. Morgan and Wilson did these things because they did not understand that the shares in question belonged to trusts even though the certificates plainly stated that they did.

The Jains were unaware of the misdeposits and false statements. Morgan secretly corrected the misdeposit of shares from one of the trusts without telling anyone of the mistaken deposit. The Jains discovered the other trust misdeposits (long before the 16(b) suit was filed) and immediately had them corrected.

The Jains never had any intention of "purchasing" any shares from the trusts. The trustee never had any intention of selling any trust shares. Any such transaction would have defeated the very estate-planning purposes for which the trusts were created. Because neither the "buyer" nor the "seller" knew that any "transactions" were occurring, there obviously was no agreed "purchase price."

C. The 16(b) Litigation

In 2001, an InfoSpace shareholder, Dreiling, filed suit in federal District Court, alleging that the Jains were liable under 16(b) because the false footnote and misdeposits amounted to "purchases" of InfoSpace stock from the trusts within six months of the Jains' sales of some of their Founders shares. Dreiling argued that 16(b) required the Jains to disgorge a sum equal to the difference between the "purchase" price (which Dreiling claimed was zero

since no price had been agreed upon) and the actual proceeds from the Jains' sale of Founders' shares—*i.e.*, 100% of the proceeds of those sales.

Perkins defended the Jains in the 16(b) Suit without seeking the Jains' waiver of its numerous conflicts of interest: Perkins was representing InfoSpace, the recipient of any 16(b) recovery, in numerous other matters, and owed it fiduciary duties; it was liable to the Jains for authoring the false footnote; and its lawyers were essential witnesses. Perkins conducted virtually no discovery of how the mistakes had come about, did not withdraw in order to testify about its own error in writing the footnote, and did not argue that issues of fact precluded summary judgment against the Jains.

On May 14, 2003, the District Court granted Dreiling's motion for summary judgment, ruling based mainly on the IPO prospectus footnote that an escrow had been established and holding that the misdeposits also were purchases. (App. F, pp. A-69 A-70). The District Court held that the issue of the Jains' innocence was "largely irrelevant" under 16(b) and that, on summary judgment, no determination could be made of whether they had acted in good faith. (*Id.*, p. A-67). The District Court's ruling was predicated on an application of the rule of "voluntariness"—*i.e.*, that the Jains had had some role in the events in question—that the Court admitted was beyond the margins of the most directly applicable precedent. (*Id.*, p. A-76).

On May 29, 2003, successor counsel, on motions for reconsideration and the determination of damages, presented new evidence that explained the

origins of the false footnote and confirmed that Morgan and Wilson had acted based on a mistaken belief that the shares belonging to the trusts were actually owned by the Jains—and had actually misled the Jains as a result of their own mistaken belief. The District Court struck some of this evidence as untimely, denied the motion for reconsideration and held that the Jains were liable for one hundred percent of the proceeds of their Founders' share sales because the trust share "purchases" had been for zero. (App. E, p. A-51).

Judgment was entered against the Jains in the sum of approximately $247 million, including prejudgment interest (*id.*, p. A-60) – by far the largest 16(b) judgment in history. In awarding prejudgment interest, the District Court held that it could not make any determination of whether the Jains were in fact innocent and had acted in good faith. (*id.*, pp. A-55).

On February 23, 2004, the Jains appealed to the Ninth Circuit. To avoid foreclosure on their assets at fire-sale prices, they were forced to liquidate their stock portfolio and buy low-yield bonds as collateral for a $253 million appeal bond. This asset shift led to more than $10 million in demonstrable investment losses—gains that actually would have accrued to their pre-existing portfolio.

On February 15, 2005, the Jains settled by paying InfoSpace $65 million (plus $40 million in insurance).

II. Proceedings Below

A. Filing, Removal and Remand

In August, 2003, the Jains commenced this action by filing their original Complaint against Morgan and others (including InfoSpace and its general counsel) in Washington State Superior Court.

The Jains alleged that defendants were responsible, through their errors and omissions, for creating the fictitious escrow "purchase" and for negligently misdepositing trust shares (and in two cases re-registering them); and that the misdeposits, coupled with the false footnote, all of which occurred without the Jains' knowledge (or that of the trustee), were predicates for the Jains' 16(b) liability and resulting damages. The Jains asserted causes of action for breach of fiduciary duty, negligence, unjust enrichment/set-off, and equitable subrogation.

The original defendants removed the case to District Court, where the case was assigned to the same judge who had rendered the 16(b) judgment. Defendants asserted that the District Court had original "federal question" jurisdiction over the Jains' claims because "the established federal policy against allowing indemnification or 'reimbursement' for securities liability bars plaintiffs' claims."

The Jains moved for remand, arguing that "defendants are not parties because of any contribution, indemnity, or 'reimbursement' claim, but because the defendants are directly liable to the

Jains by reason of the defendants' negligence and breaches of fiduciary duties." The Jains further asserted that "[n]o federal law or policy precludes asserting claims under state common law for breaches of fiduciary duties and negligence for damages incurred by a plaintiff in a lawsuit involving Section 16(b) claims."

On January 9, 2004, the District Court remanded the case, stating that:

> [The Jains] are not seeking through this lawsuit to challenge their Section 16(b) liability or to escape enforcement of their Section 16(b) liability.
>
> ...
>
> Instead, the Jains are merely seeking to hold other parties accountable for negligence in causing the damages they incurred as a result of their Section 16(b) liability.

(App. D, A-37). The District Court further recognized that, although the damages recoverable under the Jains' tort claims might be similar to those recoverable under an indemnification claim, the claims were distinct:

> The Jains' claims against these Defendants rests solidly in tort law. Defendants argue that the Jains' claims in this case are indemnity or reimbursement claims in disguise [but] . . . have presented no authority indicating that the elements of negligence and breach of fiduciary duty

> are the same as those for indemnification.

(*Id.*, A-41). Continuing, the District Court stated:

> While the ultimate outcome might be the same if the Jains prevail on their state law claims – i.e. the Jains will recover the amount of damages they incurred as Section 16(b) liability – this does not mean that the Jains' negligence and breach of fiduciary duty state law claims are equivalent to claims for indemnification or reimbursement.

(*Id.*, A-41).

B. Superior Court

Before the action against Morgan and others was remanded, on October 9, 2003 the Jains initiated an action against Perkins in Superior Court. The two actions subsequently were consolidated.

By September 2005, the Jains had settled the underlying 16(b) case and dismissed certain of the original defendants.

On September 19, 2005, the Jains filed their Third Amended Complaint against Morgan and Wilson and their Second Amended Complaint against Perkins. The Jains alleged that Respondents' negligent acts and omissions had caused the 16(b) judgment against them and that

they had acted reasonably in settling, were innocent of any wrongdoing and had been affirmatively misled by the professionals.

The Jains also alleged that their losses could have been avoided had Perkins not had unwaivable conflicts of interest that motivated them to avoid discovery, to refrain from advancing key arguments regarding the origins of the "purchases," to avoid withdrawing and testifying that the footnote was false and even to shrink from arguing that issues of fact precluded summary judgment against their clients.

Asserting claims for negligence, breach of fiduciary duties, equitable apportionment, unjust enrichment, recovery of non-settlement damages, and equitable indemnity, the Jains sought, among other things, a declaration that Respondents were obligated to compensate the Jains for:

> defendants' fault-based shares, based on their respective proportionate fault, of the Jains' direct damages resulting from the judgment and settlement in the 16(b) Suit, including, but not limited to, the costs and other consideration paid or granted by the Jains or on their behalf in settlement of the 16(b) Suit;
>
> ...[and for] the Jains' direct, indirect, consequential and special non-settlement damages resulting from the 16(b) Suit....

On October 25, 2005, Respondents filed motions to dismiss the Jains' Complaints for failure to state a claim, arguing that all of the Jains' claims were barred under a federal policy prohibiting "securities wrongdoers" from seeking indemnification.

On May 4, 2006, the Superior Court granted Respondents' motions, dismissing with prejudice the Jains' Third Amended Complaint against Morgan and Wilson and the Jains' Second Amended Complaint against Perkins. (App. C).

C. Court of Appeals

On October 20, 2006, the Jains appealed the orders of dismissal directly to the Supreme Court of the State of Washington, which then transferred the appeal to the Washington State Court of Appeals on March 6, 2007.

On January 14, 2008, the Court of Appeals affirmed dismissal, determining that the Jains' state law claims were barred by a federal policy against "de facto indemnity" for securities liability, specifically 16(b) liability. (App. B). While conceding that securities professionals and defense counsel "should be answerable in state court for harms they have caused their clients," the court found that "to the extent that state claims constitute any form of indemnification, the strict liability provisions of section 16(b) would be fatally undermined were insiders able to pursue those claims[.]" (*Id.*, A-15). Accordingly, the court held that "because they seek recovery of the profits they were required to disgorge to InfoSpace, the Jains'

claims constitute de facto indemnification and present an insuperable bar to relief." (*Id.*, A-16). The court also noted, in connection with its separate ruling denying the Jains' claim for attorneys' fees (on state law grounds) that the Jains "were not blameless in the transactions giving rise to their [16(b)] liability." (*Id.*, A-17). The conduct described to support this statement was the same conduct the District Court had ruled constituted "voluntariness"; *i.e.*, the Jains did such things as sending the stock certificates to their broker, failing to immediately detect the misdeposits, and signing the IPO prospectus. No court has held that the Jains were even negligent.

D. State Supreme Court.

On October 1, 2008, the State Supreme Court denied the Jains' Petition for Review. (App. A).

REASONS FOR GRANTING THE WRIT

The Circuits that have addressed the extent to which federal law bars state law claims for losses arising from securities liability by classifying such claims as "de facto indemnity" claims have reached widely different conclusions. The question this Petition raises is how to set the boundaries of any such federal policy so that it supports both the specific goals of the federal statute involved and the broader objectives of the federal securities laws.

Some Circuits have applied the anti-indemnity rule in ways that undermine legitimate state remedies, promote no goal of the federal securities law at issue, and immunize securities

professionals from the consequences of their own negligence. This case was decided in reliance on such rulings. Other Circuits recognize, but in varying degrees, the right of the injured party to recover losses in proportion to the fault of the securities professionals even where (unlike this case) the client was also negligent.

This case is an extreme example of the evils of the "de facto indemnity" bar under the facts the Jains allege. However, the Jains' claims were rejected *on a motion to dismiss*. A pure issue of law is presented here, essentially untainted by the factual complexity reflected in the record.

The specific goals of 16(b) were met when the Jains disgorged their "profits" to InfoSpace in settling to avoid appeal risks (largely created by their defense counsel's failures in connection with the summary judgment motion below). Their state law claims seek to do nothing more than allocate these damages (and their separate investment losses) in proportion to the fault of Respondents. It is a verity on this record that the Jains had no knowledge that the "transactions" were even occurring (the escrow did not occur). This is not a case of negligent advice; the Respondents literally created the short-swing trades through their mistakes. Neither the disgorgement policy of 16(b) nor its deterrence goals are implicated here—one cannot be deterred from engaging in transactions of which one is unaware.

A rule that classifies the Jains' claims as "de facto" indemnity claims that are barred by federal law defeats the federal securities law goal that *is*

implicated here: discouraging careless conduct by securities professionals. The claims are not for "indemnity" because the Jains do not seek to shift damages arising from their own fault, but only to recover their losses to the extent they arose from the careless conduct of others.

The goals of encouraging prudence by securities professionals will be served by this Court's defining a rule that bars only claims for true "indemnity" (shifting damage attributable to the indemnitee's fault or wrongdoing) while upholding the states' right to provide remedies that simply allocate losses according to fault. This rule should apply even in favor of parties who, unlike the Jains, were themselves at fault in creating their own liability as long as the result is not to shift any portion of the loss that is properly allocable to the plaintiff.

I. The Circuits Are Split

Each Circuit examining the issue has determined that there are circumstances in which a party found liable under the federal securities laws may be prohibited from pursuing claims against third parties for their role in causing that liability or associated losses. As stated by one commentator:

> The cases dealing with indemnification questions in the context of federal securities liability ... do not deal with claims for indemnification against securities law liabilities in an entirely consistent fashion; groups of the cases use three somewhat different standards

> to determine whether a defendant is entitled to be indemnified by other defendants. Some cases take – or at least appear to take – the position that a defendant in a securities action may claim indemnity from another defendant whose degree of fault was greater. Other cases bar indemnification for defendants whose liability is premised on intentional, knowing or reckless behavior, independent of the quality of the behavior of the other defendants in the action, on the rationale that to permit indemnification of such defendants would undercut the deterrent mission of the federal securities laws. On essentially the same rationale, other cases at least suggest that indemnification should be denied to defendants whose liability is based on negligent violations. Some courts have held that indemnification is contrary to public policy for section 16(b) cases, even though the liability arising under section 16(b) for short-swing trading by insiders is the consequence of a strict liability scheme created by statute that does not require any proof of fraudulent intention or negligence.

Deborah A. DeMott, *Shareholder Deriv. Actions L. & Practice*, § 6:43 (2008) (citations omitted[1]).

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[1] Citing, in connection with the discussion of 16(b), *First Golden Bancorporation v. Weiszmann*, 942 F.2d 726 (10th Cir. 1991).

The Second Circuit, in a securities fraud case under § 10(b) of the 1934 Act (15 U.S.C. § 78j(b)), involving an issuer who omitted material facts from an offering circular, prohibited the underwriter from enforcing an indemnification agreement with the issuer where the underwriter was reckless. *Globus v. Law Research Service, Inc.*, 418 F.2d 1276 (2d Cir. 1969). The court found that, where the underwriter had actual knowledge of the misstatement and exhibited "wanton indifference ... to its obligations, 'it would be against public policy embodied in the federal legislation to permit [the underwriter] to enforce its indemnification agreement.'" *Id.*, at 1288. The court added that it was considering only the case were the putative indemnitee "has committed a sin graver than ordinary negligence." *Id.* Taking its cue from the Second Circuit's decision in *Globus*, the District Court for the Southern District of New York has issued a series of cases allowing claims of indemnification by innocent, or merely negligent, defendants accused of violating the federal securities laws.[2] The Jains' claims should have been upheld under this approach.

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discussed *infra*, and the present case.

[2] Citing *Globus* and *Herzfeld v. Laventhol, Krekstein, Horwath & Horwath*, 378 F.Supp. 112 (S.D.N.Y. 1976), the court in *Cambridge Fund, Inc. v. Abella*, 501 F.Supp. 598, 618 (S.D.N.Y. 1980) explained that, "these decisions stand for the proposition that it is against public policy to allow a party who has been adjudicated to have been engaged in reckless, willful or criminal conduct to shift his liability to others." In *Cambridge Fund*, the public policy did not bar indemnification because there had been "no adjudication of willfulness." *Id.*, at 619. The same court later explained that:

> [T]he crucial relevant fact in determining whether indemnification for violations of the

In contrast, the Fourth Circuit has not limited the bar to cases of the claimant's intentional wrongdoing. It has held that the federal securities laws "preempt plaintiff's pendent state claims to the extent they allow a right of action for

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> securities laws is available is whether the defendant acted with actual knowledge of falsity or reckless disregard for the truth. . . . [W]hether indemnification is available may depend on various questions of fact such as whether a party is personally at fault, actually contributed to an injury, incurred merely vicarious or imputed liability, or had actual knowledge of alleged misstatements.

Arden Way Assoc. v. Boesky, 664 F. Supp. 863, 865 (S.D.N.Y. 1987). In *Greenwald v. American Medcare Corp.*, 666 F.Supp. 489 (S.D.N.Y. 1987), where defendants accused of securities fraud settled prior to trial, one defendant asserting complete innocence was permitted to pursue his indemnification claim against co-defendants. *Id.*, at 493 ("Spanakos is entitled to an opportunity to prove that he was without fault and is therefore entitled to indemnity."). Explaining the rationale behind *Globus* and its progeny, the court in *Fromer v. Yogel*, 50 F.Supp.2d 227 (S.D.N.Y. 1999) stated that indemnification:

> is not available in a case where the party seeking indemnification has knowingly and willfully violated the federal securities laws. Such a remedy would allow a tortfeasor to shift liability for intentional misconduct onto another joint tortfeasor and thereby undercut the deterrence goals of the securities laws.
>
> ...
>
> [However,] indemnity claims under the Exchange Act may proceed where the wrong committed by those seeking indemnity is no greater than ordinary negligence.

Id., at 237-38 (citations, footnote omitted) (emphasis added).

indemnification." *Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1102 (4th Cir. 1989). In *Baker, Watts*, investors successfully sued Baker, Watts under § 12(2) of the 1933 Act for material omissions in an offering memorandum. The corporation then asserted claims for contribution and indemnification against the law firm that drafted the offering memorandum. *Id.*, at 1103. Noting that liability under § 12(2) does not require scienter but may be "predicated upon negligent misrepresentations," the court refused to pre-empt the state law *contribution* claims, based on the law firm's "independent obligation to provide competent legal representation." *Id.*, at 1108. However, the court held that federal policy bars any state-based *indemnification* claims:

> [T]he underlying purpose of the 1933 Act is regulatory rather than compensatory. Negligence in the preparation of a securities prospectus was made actionable under § 12(2) of the 1933 Act in order to promote careful adherence to the requirements of the statute. . . . [A] right of action for indemnification would frustrate the statute's goal of encouraging diligence and discouraging negligence in securities transactions.

Id., at 1105 (quotations, citations omitted). Although the court determined that the federal policy against indemnification is not limited to circumstances where the underlying liability was based on intentional wrongdoing, it stopped short of

establishing a bright line rule barring all claims for indemnification:

> Although a right to indemnification may not be preempted in each and every circumstance, we reject plaintiff's assertion that the federal policy against indemnification extends only to intentional wrongdoing.

Id., at 1108.

The Seventh Circuit, having initially adopted a broad rule barring indemnification claims by "securities wrongdoers," now allows such claims to the extent that they have an independent legal basis in state or federal law. In *Heizer Corp. v. Ross*, 601 F.2d 330, 334 (7th Cir. 1979), the court barred a cross-claim for indemnification of liability imposed for securities fraud, stating that "indemnification tends to frustrate" the policy of securities legislation and that a "securities wrongdoer should not be permitted to escape loss by shifting his entire responsibility to another party." The court later disavowed *Heizer's* policy-based approach. *King v. Gibbs*, 876 F.2d 1275, 1283 (7th Cir. 1989) ("policy analysis has no role to play in the question of whether there is a federal right to indemnification") (*citing Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 638, 101 S.Ct. 2061 (1981)). In *King*, defendant Gibbs faced claims under § 10(b) and SEC Rule 10b-5. He claimed that, as an "innocent conduit of false information" transmitted by cross-claim defendants, the rule of *Heizer* (barring indemnification claims by "securities *wrongdoers*") was inapplicable. *Id.*, at 1276. Apparently in

agreement, the court focused on whether Gibbs could establish a legal basis for his indemnity claims. Gibbs could not rely on state law only because he had failed to preserve the argument. *Id.*, at 1279, n.5. Thus, he was required to show "a right to indemnification under federal law." *Id.*, at 1279. Engaging in an extensive analysis of legislative history and federal common law principles, the court held that, regardless of the level of the claimant's culpability, "there is no right to indemnification under the securities laws or federal common law." *Id.*, at 1276.

Before *King* called *Heizer* into question, the Ninth Circuit invoked *Heizer's* policy arguments to bar a "cross claim for indemnity." *Laventhol, Krekstein, Horwath & Horwath v. Horwitch,* 637 F.2d 672, 676 (9th Cir. 1980). *Laventhol* involved claims for securities fraud under § 11 of the 1933 Act, 15 U.S.C. § 77k. The issue was whether certain non-settling defendants could pursue indemnification or contribution against defendants who had settled for a nominal amount in exchange for their agreement to cooperate with plaintiffs. After noting that contribution was permitted by statute, the court held that the cross-claim for indemnity had been properly dismissed:

> In extending liability to underwriters and those who prepared misleading statements, the purpose of the Act is regulatory rather than compensatory, and permitting indemnity would undermine the statutory purpose of assuring diligent performance of duty and deterring negligence.

Id., at 676. However, the District Court for the Northern District of California has determined that federal law does not bar a corporation's voluntary indemnification of its directors and officers for payments made to settle a securities fraud class action under SEC Rule 10(b)-5, where such indemnification is permitted by state law. *Raychem Corp. v. Fed. Ins. Co.*, 853 F. Supp. 1170, 1177-78 (N.D. Cal. 1994).

The Tenth Circuit is the only Court of Appeals that has addressed the indemnification issue in the context of liability imposed by 16(b). In *First Golden Bancorporation v. Weiszmann,* 942 F.2d 726 (10th Cir. 1991), defendant Weiszmann acquired First Golden stock as a result of a tender offer, which he then sold within six months. First Golden sued Weiszmann under the strict liability provisions of 16(b), which require disgorgement to the issuer of all profits resulting from a statutory insider's[3] sale and purchase, or purchase and sale, of stock within a given six-month period. Weiszmann filed a third-party complaint against his financial advisor, seeking (among other things) "indemnification for any liability he may have to First Golden." *Id.*, at 728. Weiszmann and First Golden settled the primary 16(b) lawsuit on terms that did not require Weiszmann to make any payment to First Golden, though he was required to dismiss certain unspecified counterclaims. *Id.* The court noted that other federal courts have "rejected indemnity for a variety of securities violations" as a matter of policy,

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[3] Although the basis for concluding that Weiszmann was an "insider" subject to 16(b) is not stated, it appears likely that he qualified as a "beneficial owner" with more than 10% of the corporation's stock. 15 U.S.C. § 78p(a), (b).

including that "indemnity would undermine the deterrent purpose of the Acts." *Id.*, at 728-29 (citations omitted). The court found these concerns "applicable to indemnification in section 16(b) cases, even though section 16(b) does not require proof of fraudulent intent" but did not address the differences among the cases it cited, including the Second Circuit's recognition in *Globus*, *supra*, that innocent or merely negligent parties may pursue fault-based claims. *Id.*, at 729. In light of the "clear congressional intent to provide a catch-all, prophylactic remedy, not requiring proof of actual misconduct" the court held that "the public policy behind section 16(b) renders invalid any attempt by an insider to seek indemnification for his liability under section 16(b)." *Id.* (citations omitted).[4]

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[4] Other lower court decisions addressing indemnification for 16(b) liability have taken a more limited approach, concluding that the *issuer* may not indemnify the insider without defeating the 16(b) remedy of disgorgement *to* the issuer. *See, e.g., Bunker Ramo-Eltra Corp. v. Fairchild Industries, Inc.* 639 F. Supp. 409, 419 (D. Md. 1986); *Schaffer v. CC Invs., LDC*, 286 F. Supp. 2d 279, 283 n.6 (D.N.Y., 2003); *In re XO Communications, Inc.*, 330 B.R. 394, 441 (S.D.N.Y. 2005) ("The court is persuaded that allowing indemnification for [Section] 16(b) violations [by the issuing corporation] would frustrate the public policy behind the statute because liable parties would not have to return their short-swing profits to the plaintiff issuer.") (quoting from *Schaffer* but adding the bracketed language). *Bunker-Ramo* explained this rationale, in the context of contractual indemnification by the issuer:

> If this indemnification is found to be valid, then the defendants would have been able to waive, in effect, the requirement of section 16(b) since they would not have to *return* the short-swing profits *back to the plaintiff issuer*.

In affirming the Superior Court's dismissal of the Jains' claims for failure to state a claim, the Court of Appeals relied heavily on *First Golden.* (App. B).

The Third and Eleventh Circuits have considered the issue only in the context of the lower courts' issuance of a "settlement bar order" barring cross-claims for contribution and indemnification between settling and non-settling defendants accused of federal securities law violations.

The Eleventh Circuit bars settling defendants from seeking contribution, indemnity or asserting "interrelated" state law claims against a non-settling defendant. *In re U.S. Oil & Gas Litigation,* 967 F.2d 489 (11th Cir. 1992). In a securities fraud class action involving the sale of investor advisory services related to the purchase of federal oil and gas leases, defendant Pinnacle settled with the plaintiff class before trial, but wished to preserve its cross-claims against a non-settling co-defendant, A&A. *Id.*, at 492. Pinnacle asserted claims for indemnity, fraud, breach of fiduciary duty, and negligence, alleging that A&A wrongfully withheld information of the fraudulent activities. *Id.* The court issued a settlement bar order prohibiting Pinnacle from pursuing its cross-claims, primarily based on policy considerations favoring settlement of complex class action cases. *Id.*, at 493. The court found that independent state law claims, including fraud and negligence, that are "interrelated" with the

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Id., at 419 (emphasis added). Such a result would be a direct violation of Section 29(a) of the Securities Exchange Act – the "anti-waiver provision" – because the issuer would not recover the short-swing profits, as required by 16(b). *Id.*, at 418-19.

indemnification claim and founded on the same facts may be the subject of a proper settlement bar:

> The propriety of the settlement bar order should turn upon the interrelatedness of the claims that it precludes, not upon the labels which parties attach to those claims. If the cross-claims that the district court seeks to extinguish through the entry of a bar order arise out of the same facts as those underlying the litigation, then the district court may exercise its discretion to bar such claims in reaching a fair and equitable settlement.

Id. at 496. The court did not rule on whether a settlement bar order could bar "truly independent" claims. *Id.*, at 496, n.5; *see also AAL High Yield Bond Fund v. Deloitte & Touche, LLP*, 361 F.3d 1305, 1312 (11th Cir. 2004) ("the [*U.S. Oil & Gas*] opinion expressly declined to address the issue of 'truly independent claim'"). In *dictum*, the court also noted that "the substantive weakness of Pinnacle's indemnity claim supported the entry of the settlement bar against it" and that "[i]ndemnification claims are not cognizable under the Securities Acts of 1933 and 1934." *In re U.S. Oil & Gas*, 964 F.2d at 495 (citation omitted).

In the Third Circuit, while claims for true indemnification are not permitted as a matter of federal policy, a party liable under the securities laws may recover its losses from a party who has breached independent state law duties to the

claimant. In a securities fraud case involving the sale of securities at artificially inflated prices, plaintiffs settled with certain defendants and the trial court entered an order barring "all claims for contribution or indemnification however denominated" by non-settling defendants (including the underwriter) against settling defendants. *Eichenholtz v. Brennan*, 52 F.3d 478, 481 (3rd Cir. 1995). Affirming issuance of the "settlement bar" order, the court stated that claims for indemnification "run counter to the policies underlying the securities acts":

> The underlying goal of securities legislation is encouraging diligence and discouraging negligence in securities transactions. These goals are accomplished "by exposing issuers and underwriters to the substantial hazard of liability for compensatory damages."

Id., at 484 (citations omitted). The court agreed with other courts that have held the policy against indemnification applies even where the liability imposed by the securities laws is predicated on mere negligence. *Id.*, at 484-85. The court also upheld the bar order as to any contribution claims, because any subsequent judgment against the non-settling defendants would be reduced in proportion to the settling defendants' relative culpability: "The proportionate fault rule is the equivalent of a contribution claim; the non-settling defendants are only responsible for their portion of the liability." *Id.*, at 487. However, because the bar order barred only claims against *settling* defendants, the non-settling underwriter could seek indemnification from

its *non-settling* co-defendant agent "if it is held vicariously liable for [its agent's] conduct." *Id.*, at 485, n.13. The lower courts in the Third Circuit similarly have distinguished between barred indemnification claims and state law claims for breaches of independent duties.[5]

The First, Fifth, and Eighth Circuits each have acknowledged, in *dicta*, the other Circuits' treatment of the issue. *See Happ v. Corning, Inc.*, 466 F.3d 41, 44 (1st Cir. 2006) (recognizing view in "some circuits" that "federal law—although only by implication—forbids indemnification for federal regulatory violations like insider trading") (citing *First Golden*, *Globus*, and *Raychem, supra*); *Stowell v. Ted S. Finkel Investment Services*, 641 F.2d 323, 325 (5th Cir. 1981) ("indemnification tends to frustrate the policy of securities legislation.") (citing *Heizer, supra*); *Professional Beauty Supply, Inc. v. National Beauty Supply, Inc.*, 594 F.2d 1179, 1186 (8th Cir. 1979) (noting, in antitrust case, that "the sound reasoning of the security cases which deny indemnity to tortfeasors who have committed a

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[5] *See, e.g., In re Cendant Corp. Sec. Litig.*, 139 F. Supp. 2d 585, 595 (D.N.J. 2001):

> merely because Cendant's tort and contract claims seek to recover damages that could be recoverable in a state law indemnity action do[es] not convert these claims into impermissible indemnity claims under the federal securities laws. Rather, they are independent, non-indemnity claims that are neither barred nor preempted by the federal securities laws.

See also In re Sunrise Sec. Litig., 793 F.Supp. 1306, 1321 (E.D.Pa. 1992) (same).

wrong graver than ordinary negligence is equally applicable here.") (citations omitted).

II. This Court's 16(b) Decisions

This Court has never addressed whether, or to what extent, a statutory insider held strictly liable under the provisions of 16(b) may attempt to hold third parties accountable for their role in causing that liability. This Court has not addressed the scope of a defendant's liability under 16(b) since issuing a set of three decisions in the 1970s. In each case, the Court ameliorated the harsh effect of the strict liability provisions of the statute, by narrowing the circumstances under which liability
would be found.

A. *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 92 S.Ct. 596, 30 L.Ed.2d 575 (1972)

In *Reliance*, this Court was asked to determine whether the owner of more than 10% of a corporation's shares could retain some of its "short-swing" profits by selling the entirety of its holdings in two steps – the first designed to reduce its holdings just below the 10% threshold. Section 16(b) requires that all "short-swing" profits be disgorged where the owner held more than 10% "both at the time of the purchase and sale." This Court held that any profits from the second sale were not recoverable by the corporation even though the transactions expressly were designed to "avoid" 16(b) liability.

Emerson Electric Co. acquired 13.2% of the stock of Dodge Manufacturing Co. pursuant to a tender offer made in an unsuccessful takeover attempt. Shortly thereafter, Dodge shareholders approved a merger with Reliance Electric Co. Emerson thereupon embarked upon a two-step plan to sell its holdings, designed to avoid the full impact of 16(b). First, Emerson sold 37,000 shares to a holding company, reducing its stake in Dodge to 9.96%. Then, two weeks later, it sold the remainder to Dodge.

Reliance demanded the profits from both sales, and Emerson filed a lawsuit seeking a declaration of non-liability. This Court accepted certiorari to the Court of Appeals for the Eighth Circuit.

Discussing the history and purpose of 16(b), this Court recognized that Congress had adopted a "flat rule" of strict liability designed to remove any profits from "a class of transactions in which the possibility of abuse was believed to be intolerably great." *Id.*, at 422. The rule would be applied mechanically and have "sweeping coverage" so as to "insure the optimum prophylactic effect":

> In order to achieve its goals, Congress chose a relatively arbitrary rule capable of easy administration. The objective standard of Section 16(b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation. This approach

> maximized the ability of the rule to eradicate speculative abuses by reducing difficulties in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect.

Id. (quoting *Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir. 1970)).

Reliance argued that Emerson's two sales should be treated as part of a single transaction and that Emerson should be treated as having been a 10% owner "at the time of the [second] sale." The Court rejected the argument:

> To be sure, where alternative constructions of the terms of 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders. But a construction of the term "at the time of ... sale" that treats two sales as one upon proof of a pre-existing intent by the seller is scarcely in harmony with the congressional design of predicating liability upon an "objective measure of proof."

Id., at 424-25 (citation omitted). Accordingly, the Court found that Emerson was not required to disgorge any profits from the second transaction because it technically was not a 10% owner at the time. *Id.*, at 424-25.

B. *Kern County Land Co. v. Occidental Petroleum Co.*, 411 U.S. 582, 93 S.Ct. 1736, 36 L.Ed. 503 (1973)

One year later, in *Kern County*, the Court again limited the reach of 16(b), this time by narrowly construing the term "sale" as not to include certain "unorthodox" transactions where there is no opportunity for "speculative abuse" based on inside information.

As in *Reliance*, *Kern County* involved a failed takeover attempt. Defendant Occidental became a "beneficial owner" subject to 16(b) when it acquired more than 10% of Kern's stock in a tender offer. Soon thereafter, Kern and Tennecco signed a merger agreement that, upon approval by Kern's shareholders, would entitle Occidental to exchange each share of Kern stock for one share of Tennecco stock. So as not to become a minority shareholder of Tennecco, Occidental and Tennecco entered into a call option contract whereby Tennecco acquired the right to purchase Occidental's Tennecco stock outside the six-month short-swing period. Subsequently, Occidental exchanged its Kern shares and Tennecco exercised its option, resulting in total profits to Occidental of almost $20 million.

Citing its introductory clause, the Court noted that 16(b) was enacted "for the purpose of preventing the unfair use of information which may have been obtained by (a statutory insider) ... by reason of his relationship to the issuer." *Id.*, at 591. Citing the statute's legislative history, the Court also noted that "the bill aimed at protecting the public 'by preventing directors, officers, and principal

stockholders of a corporation ... from speculating in the stock on the basis of information not available to others" (*id.*, at 592) and reflects "a congressional effort to curb short-swing trading by insiders whose position gives them access to information not available to the investing public and the ability to influence corporate policy." *Id.*, at 592, n. 23.

Although the Court noted that many decisions have been read to apply an "objective" test under 16(b), "[b]y far the greater weight of authority is to the effect that a "pragmatic" approach to 16(b) will best serve the statutory goals." *Id.*, at 594, n.26.

The Court recognized that Occidental "knew it could sell its stock to the target company's merger partner at a substantial profit" if its own takeover attempt was unsuccessful. *Id.*, at 597. But this was not the type of speculation 16(b) was designed to prevent. Ultimately, the Court found that any "sales" by Occidental were essentially "involuntary" and, due to the hostile nature of the takeover bid, not based on inside information:

> [T]he involuntary nature of Occidental's exchange, when coupled with the absence of the possibility of speculative abuse of inside information, convinces us that 16(b) should not apply to transactions such as this one.

Id., at 600. Similarly, because the "call" option contract afforded the buyer – Tennecco – the right, in its discretion, to purchase the Kern shares, there was no possibility of "speculative abuse" because

Occidental would not benefit from a rising market. *Id.*, at 602.

C. *Foremost-McKeeson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 96 S.Ct. 508, 46 L.Ed.2d 464 (1976).

In *Foremost*, the Court continued to narrow the circumstances in which a statutory insider may be found liable under 16(b). As in *Reliance Electric*, where the Court found a "beneficial owner" must own more than 10% immediately prior to any *sale* subject to 16(b), in *Foremost*, the Court created symmetry by holding that the owner must have owned more than 10% immediately prior to any *purchase* subject to 16(b).

Provident Securities Co. sold its assets to Foremost in exchange for cash and debentures immediately convertible into more than 10% of Foremost stock. *Id.*, at 236. The next day, the parties entered into an underwriting agreement with a third party, pursuant to which Provident sold a substantial amount of the debentures to an underwriter for slightly more than face value. Provident then sued for a declaration that it was not liable to Foremost for any profits on the sale of the debentures.

Provident argued that it fell within the "exemptive provision" of 16(b) –exempting transactions "where such beneficial owner was not such both at the time of the purchase and sale" – because it was not a 10% owner of Foremost stock at the time it initially acquired the debentures. *Id.*, 239. The Court of Appeals agreed: "Congress

intended to reach only those beneficial owners who both bought and sold on the basis of inside information, which was available to them only after they became statutory 'insiders.'" *Id.*, at 242-43.

While Foremost acknowledged the ambiguity of the "exemptive provision," it argued that "where 'alternative constructions' of 16(b)'s terms are available, [courts] should choose the construction that best serves the statute's purposes" relying on *Reliance Electric* and *Kern County*. However, the Court rejected the argument:

> In neither of those cases, however, did the Court adopt the construction that would have imposed liability, thus recognizing that serving the congressional purpose does not require resolving every ambiguity in favor of liability under 16(b).

Id., at 252.

III. Claims to Apportion Damages for Violations of the Federal Securities Laws Based on FaultShould Be Treated Uniformly

While this Court never has had occasion to address whether state law claims may be barred as "indemnity" or "de facto" indemnity claims for securities law liability, it came closest to doing so in *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 508 U.S. 286, 113 S. Ct. 2085, 124 L. Ed. 2d 194 (1993). There, the Court concluded that there was an implied right of contribution under § 10(b) of the 1934 Act and SEC Rule 10b-5. In reaching its

decision, the Court determined that, even where the claimant was adjudged liable for intentional wrongdoing, the right to contribution was not at odds with any policy underlying or expressed in the 1934 Act. *Id.*, at 298.

Two years later, Congress passed the Private Securities Litigation Reform Act of 1995 ("PSLRA"), codifying an express right to contribution. 15 U.S.C. § 78u-4(f)(8). The legislative history of the PSLRA explains the rationale behind contribution in cases involving the federal securities laws:

> One of the most manifestly unfair aspects of the current system of securities litigation is its imposition of liability on one party for injury actually caused by another. . . .
>
> The current system of joint and several liability creates coercive pressure for entirely innocent parties to settle meritless claims rather than risk exposing themselves to liability for a grossly disproportionate share of the damages in the case.

H.R. Conf. Rep. No. 104-369 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 736-37.

The Jains cannot claim contribution in this action because 16(b) liability extends only to the insider whose purchases and sales occur within six months of each other. "Contribution" arises only where there is joint liability. Parties who caused short-swing transactions, for which the Jains were

held strictly liable, are not liable to the issuer under 16(b). The relief sought by the Jains in this action, however, is conceptually and substantively similar to the contribution rights recognized by this Court in *Musick, Peeler* and determined by this Court to be consistent with the policy underlying the 1934 Act. It also is consistent with the policies embodied in the PSLRA.

Fault-based claims for damages arising from 16(b) liability should not be barred under federal law unless doing so would defeat 16(b)'s deterrent policies, including its prescription of a "flat rule" designed for "mechanical application." Liability under 16(b) does not imply wrongdoing or even fault—it is "strict." The purpose of the statute is to make short-swing trades pointless—*i.e.*, by assuring that the insider must disgorge any profit to the issuing corporation. For this reason, contractual indemnity *by the issuer* has been properly held to be inconsistent with federal law (and 16(b)).[6] Such indemnity would defeat the disgorgement policy that is central to deterrence.

Where the insider has paid the issuer but seeks to recover all or part of the loss because the trades arose from the negligence of securities professionals, allowing recovery is not inconsistent with 16(b)'s policies. First, the statute's mechanical application has produced the intended result: the insider has paid any profit over to the issuer. Second, the deterrent effect of 16(b) has been achieved: the insider retains no profits, but only the right to establish that others were at fault in

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[6] *See* n.4, *supra*.

creating the conditions that gave rise to liability. As in the case of classic "contribution," one cannot be "deterred" from being the victim of others' mistakes.

This case starkly presents the central question on which the Circuits differ: Can securities professionals escape responsibility for negligence on public policy grounds where the objectives of the securities statute under which their client's loss occurred were satisfied? The Jains have disgorged their "profits" via the settlement. Section 16(b)'s deterrent policy—including its mechanical application approach to liability—has been achieved. No policy of 16(b) outweighs the clear policy of the securities laws to deter negligence, and encourage prudence, by professionals who handle securities transactions for their clients and author the prospectuses on which investments are based. No "anti-indemnity" policy should bar the Jains from allocating their losses to those whose negligence caused them.

By contrast, an "anti-indemnity" policy limited to cases where a securities law violator seeks damages allocable to its own negligence or wrongdoing serves the same federal goal as allowing fault-based claims: encouraging prudence and probity.

The Second, Third and Seventh Circuits appear to have struck the appropriate balance, allowing claims that allocate losses according to fault. The Tenth and Eleventh Circuit do not permit such claims. The result in the remaining Circuits is less clear.

This thicket of contradictory approaches across the Circuits creates many routes for negligent securities professionals to escape responsibility for the damage they have caused. Like the Jains, the clients of such professionals are left in the lurch when no sound reason exists for the federal courts to sponsor such a result.

CONCLUSION

For the foregoing reasons, Naveen and Anuradha Jain respectfully request that the Court grant their Petition for Writ of Certiorari.

DATED this 30th day of December, 2008.

DANIELSON HARRIGAN LEYH & TOLLEFSON LLP

By: /s/ Arthur W. Harrigan, Jr.
Arthur W. Harrigan, Jr.
Counsel of Record
WSBA #1751
Timothy G. Leyh,
WSBA #14853
Christopher T. Wion
WSBA #33207

Robert B. Gould
LAW OFFICES
2110 North Pacific Street, Suite 100
Seattle, Washington 98103

Attorneys for Petitioners Naveen Jain and Anuradha Jain

APPENDIX A

THE SUPREME COURT OF WASHINGTON

NAVEEN JAIN and ANURADHA JAIN, husband and wife, and their Marital community,	)	NO. 81388-4
	)	ORDER
Petitioners,	)	C/A NO. 59661-6-I
v.	)	
J.P. MORGAN SECURITIES, INC., A Delaware corporation, as successor In interest to Hambrecht & Quist LLC; WILSON SONSINI GOODRICH & ROSATI, P.C., a California professional Corporation; and PERKINS COIE LLP,	)	
Respondents.	)	
NAVEEN JAIN and ANURADHA JAIN,	)	
Petitioners	)	
v.	)	
PERKINS COIE, LLP,	)	
Respondents.	)	

Department I of the Court, composed of Chief Justice Alexander and Justices C. Johnson, Sanders, Owens and J. Johnson, at its October 1, 2008, Motion Calendar, considered whether review should be granted pursuant to RAP 13.4(b), and unanimously agreed that the following order be entered.

IT IS ORDERED:

That the Petition for Review is denied. The Respondents' joint motion to strike the reply to answer is granted.

DATED at Olympia, Washington this 1st day of October, 2008.

For the Court

/s/ Gerry L. Alexander
CHIEF JUSTICE

APPENDIX B

Court of Appeals of Washington, Division 1.
Naveen JAIN and Anuradha Jain, husband and wife, and their marital community, Appellants/Cross-Respondents,
v.
J.P. MORGAN SECURITIES, INC., a Delaware corporation, as successor in interest to Hambrecht & Quist LLC; Wilson Sonsini Goodrich & Rosati, P.C., a California professional corporation, Respondents,
Perkins Coie LLP, Respondent/Cross-Appellant.
No. 59661-6-I.

Jan. 14, 2008.
Reconsideration Denied Feb. 12, 2008.

Background: After settling shareholder suit for alleged "short-swing" trading, former corporate director brought action against brokerage and law firms for negligence, breach of fiduciary duty, legal malpractice, and equitable indemnity. Defendants removed to federal court. The United States District Court for the Western District of Washington, 2004 WL 212999,Pechman, J., remanded. The Superior Court, King County, Richard A Jones, J., dismissed. Director appealed.

Holdings: The Court of Appeals, Baker, J., held that:
(1) claims were de facto indemnity claims barred under federal securities law, and
(2) director did not qualify under "ABC rule" to recover attorney fees.

Affirmed.

Appelwick, C.J., filed concurring opinion.

**118 Arthur Washington Harrigan Jr., Timothy George Leyh, Katherine See Kennedy, Randall Thor Thomsen, Danielson Harrigan Leyh & Tollefson LLP, Larry Steven Gangnes, John R. Neeleman, Theodore Alexander Sheffield, Lane Powell PC, Robert B. Gould, Attorney at Law, Seattle, WA, for Appellants/Cross-Respondents.
Brian Corker Free, Michael Ramsey Scott, Hillis Clark Martin & Peterson, PS, John D. Pernick, David M. Balabanian, Bingham McCutcheon LLP, San Francisco, CA, Gregory J. Hollon, Barbara Himes Schuknecht, Robert M. Sulkin, McNaul Ebel Nawrot & Helgren, Seattle, WA, for Respondents.
Bradley S. Keller, Keith David Petrak, Attorney at Law, Howard Mark Goodfriend, Edwards Sieh Smith & Goodfriend PS, Seattle, WA, for Respondent/Cross-Appellant.

BAKER, J.
*577 ¶ 1 The Jains were found by a federal district court to have violated section 16(b) of the Securities Exchange Act of 1934.[1] The case was settled pending appeal. The Jains then brought state tort claims against a brokerage**119 and two law firms involved in the securities case. The superior court dismissed those claims, finding that they constituted de facto indemnity claims barred under federal securities law. We affirm.

¶ 2 Naveen Jain founded InfoSpace, Inc. in 1996, and served as an officer and director of the company until 2002. In 1998, InfoSpace went public, and sold

[1] Codified at 15 U.S.C.A. § 78p.(b).

five million shares of common stock. The lead underwriter of the initial public offering (IPO) was Hambrecht and Quist (subsequently acquired by respondent J.P. Morgan (Morgan)). InfoSpace was represented by respondent Perkins Coie LLP (Perkins). Respondent Wilson Sonsini Goodrich & Rosati, P.C. (Wilson) served as Morgan's counsel.

*578 ¶ 3 For the benefit of their children, Jain and his wife Anuradha established three trusts for which Jain's brother served as trustee. Two of the trusts were initially funded with two million shares of InfoSpace stock, and the third purchased one million shares of InfoSpace stock from the Jains.

¶ 4 As InfoSpace was preparing for its IPO in late 1998, Jain executed an indemnification agreement with InfoSpace, agreeing to place one million shares of InfoSpace stock into an escrow account. Jain signed a registration statement and prospectus sent to the Securities and Exchange Commission (SEC). The prospectus included a footnote disclosing the indemnity agreement, stating that Jain had placed one million shares held by one of the trusts into escrow, and indicating that Jain retained voting control over the shares. According to the Jains, no escrow account was ever actually created. Nevertheless, over the next year, Jain signed, or authorized his attorney to sign, numerous SEC filings representing that he had placed the trust shares in escrow.

¶ 5 In 1999, InfoSpace stock split two-for-one, and Jain, like other shareholders, was issued new share certificates. Two of the trusts were entitled to nearly one million shares, and the third to 500,000 shares. After the Jains mistakenly sent the trust shares to

Morgan, Morgan deposited them into the Jains' personal account. The alleged mis-deposits into the Jains' personal account were subsequently rectified, and the shares transferred to the appropriate trusts. The Jains claim not to have read their brokerage statements, and were thus initially unaware of the mis-deposits.

¶ 6 In 2001, an InfoSpace shareholder, Thomas Dreiling, filed suit in United States District Court, naming the Jains as defendants for engaging in "short-swing" trading in violation of section 16(b) of the Securities Exchange Act of 1934.

¶ 7 Dreiling alleged that the Jains engaged in four purchases that subjected them to liability for short-swing trades. He contended that the escrow set up under the *579 indemnity agreement constituted an unlawful transfer of shares from one of the trusts to Jain, triggering liability for short-swing trades. The other alleged purchases occurred at the time the InfoSpace stock split and shares intended for the trusts were deposited instead in the Jains' personal brokerage account. It was undisputed that the Jains sold InfoSpace shares within six months of the alleged purchases.

¶ 8 The district court ruled that the transferred shares were purchases for purposes of determining whether short-swing trades had occurred, and granted Dreiling summary judgment. The court entered judgment against the Jains, ordering that the putative profits realized from the sales be disgorged to InfoSpace as required under section 16(b). The court also ordered payment of prejudgment interest.

¶ 9 The Jains appealed. Pending the appeal, they obtained a supersedeas bond, and the district court stayed execution of the judgment. The SEC interceded on the Jains' behalf and filed an amicus brief in support of their appeal. Before the appeal was heard, however, the Jains entered into a global settlement with Dreiling, InfoSpace, and various insurers.

¶ 10 The Jains then filed suit against the respondents in superior court, alleging, inter alia, negligence, breach of fiduciary duty, legal malpractice, and equitable indemnity. They sought reimbursement by the respondents**120 for the costs and damages resulting from the judgment and settlement in the 16(b) suit, including attorney fees and litigation costs, as well as the loss of appreciation and other opportunity costs to their investment portfolios alleged to have resulted from obtaining the supersedeas bond. The Jains alleged various irregularities regarding the escrow account, the footnote in the SEC prospectus regarding the escrow account, the mis-deposit of split stock shares into their personal account rather than the trust account, and numerous claims of legal malpractice by Perkins in its representation of the Jains in the federal 16(b) suit.

*580 ¶ 11 The court dismissed the Jains' complaints. The Jains now appeal.

II

[1][2] ¶ 12 A trial court's ruling to dismiss a claim

under CR 12(b)(6) is reviewed de novo.[2] Dismissal is warranted only if the court concludes, beyond a reasonable doubt, the plaintiff cannot prove any set of facts which would justify recovery.[3] The court presumes all facts alleged in the plaintiff's complaint are true.[4] The court is not, however, required to accept the complaint's legal conclusions as true.[5] A motion to dismiss is granted sparingly and with care and, as a practical matter, only where it appears on the face of the complaint that there is some insuperable bar to relief.[6] Here, section 16(b) and the Washington State "ABC rule" governing attorney fees bar the Jains' claims.

De Facto Indemnification

¶ 13 Section 16(b) of the Securities Exchange Act is designed to deter transactions which have a high potential for fraud.[7] The section prohibits corporate insiders from buying and selling their company's stock within a six-month period.[8] Profits resulting from purchase-and-sale, or sale-and-repurchase transactions within a period of less than six months are commonly known as "short-swing" transactions.[9]

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[2] *Tenore v. AT & T Wireless Servs.*, 136 Wash.2d 322, 329-30, 962 P.2d 104 (1998).
[3] *Tenore*, 136 Wash.2d at 330, 962 P.2d 104.
[4] *Tenore*, 136 Wash.2d at 330, 962 P.2d 104.
[5] *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wash.2d 107, 120, 744 P.2d 1032, 750 P.2d 254 (1987).
[6] *Kinney v. Cook*, 159 Wash.2d 837, 842, 154 P.3d 206 (2007) (quoting *Hoffer v. State*, 110 Wash.2d 415, 420, 755 P.2d 781 (1988)).
[7] *First Golden Bancorporation v. Weiszmann*, 942 F.2d 726, 729 (10th Cir.1991).
[8] 15 U.S.C.A. § 78p.(b).
[9] *Roth v. Jennings*, 489 F.3d 499, 507 (2d Cir.2007).

*581 ¶ 14 Congress recognized that insiders may have access to information about their corporations not available to the rest of the investing public.[10] By trading on this information, insiders could reap profits at the expense of less well informed investors.[11] Congress sought to curb insider trading by enacting a strict rule requiring any insider who violates section 16(b) to return to the company any profits they might gain.[12]

¶ 15 Where the possibility of abuse is so intolerably great, Congress deemed such a strict rule to be the only effective method of curbing the evils of insider trading, and considered the rule's arbitrary and sweeping coverage necessary to insure the optimum prophylactic effect.[13]

[3] ¶ 16 Unlike other provisions of the securities laws, section 16(b) is a strict liability provision where questions of intent or scienter are irrelevant.[14] This approach maximizes the ability of the rule to eradicate speculative abuses by reducing difficulties in **121 proof. The thrust of the statutory scheme thus places responsibility for meticulous observance of the provision squarely on the shoulders of the insider alone.[15] The insider is deemed capable of structuring his or her dealings to avoid any possibili-

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[10] *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 243, 96 S.Ct. 508, 46 L.Ed.2d 464 (1976).
[11] *Foremost-McKesson*, 423 U.S. at 243, 96 S.Ct. 508.
[12] 15 U.S.C.A. § 78p.(b).
[13] *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422, 92 S.Ct. 596, 30 L.Ed.2d 575 (1972) (quoting *Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir.1970)).
[14] *Deephaven Capital Mgmt., LLC v. Schnell*, No. 06-844, 2007 WL 38911, 2007 U.S. Dist. LEXIS 1504, at *8 (Jan. 5, 2007)
[15] *Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir.1970).

ty of taint, and therefore must bear the risks of any inadvertent miscalculation.[16]

¶ 17 Congress recognized from the outset that section 16(b) might impose liability on some innocent insiders whose *582 short-swing transactions were wholly inadvertent.[17] Nevertheless, while the results may be harsh in individual cases, this arbitrary rule is necessary to attain the goal set forth in the statute.[18]

[4] ¶ 18 It is well settled that an insider found to have violated section 16(b) may not seek indemnification for the ensuing liability.[19] This is to prevent an insider from effectively waiving the requirement that short-swing profits be returned, thus frustrating the policy behind section 16(b).[20]

[5] ¶ 19 In addition to barring direct indemnity, the courts also bar de facto indemnification.[21] To the extent that a plaintiff's state actions are found to be de facto claims for indemnification, they are preempted.[22] Claims integrally related to securities

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[16] *Bershad*, 428 F.2d at 696.

[17] Peter J. Romeo & Alan L. Dye, Section 16 Deskbook 365 (2007).

[18] *Petteys v. Butler*, 367 F.2d 528, 532 (8th Cir.1966).

[19] *See First Golden Bancorporation*, 942 F.2d at 728-29; *Bunker Ramo-Eltra Corp. v. Fairchild Indus., Inc.*, 639 F.Supp. 409, 418-19 (D.Md.1986).

[20] *Schaffer ex rel. Lasersight, Inc. v. CC Invs., LDC*, 286 F.Supp.2d 279, 283 (2003); *Bunker Ramo-Eltra Corp.*, 639 F.Supp. at 419.

[21] *Lucas v. Hackett Assocs., Inc.*, 18 F.Supp.2d 531, 536 (E.D.Pa.1998); *Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1108 (4th Cir.1989).

[22] *Baker, Watts*, 876 F.2d at 1108.

claims that have been settled are likewise preempted by federal securities laws.[23]

¶ 20 The Jains argue that their state law claims are legally distinguishable, fault-based claims approved by federal securities law, and are not merely de facto indemnity claims. They further argue that barring their state tort claims will serve to shield brokers and law firms from negligence and breach of duty claims.

¶ 21 The respondents insist that section 16(b) serves as a categorical bar on recovery, and that the Jains' state tort actions can be viewed only as de facto indemnity claims.

¶ 22 Those courts which have dealt with indemnification under section 16(b) have reached a harsh and restrictive *583 conclusion. Given that section 16(b) is a strict liability provision, any claim which is colorable as indemnity or de facto indemnity is barred.

¶ 23 For guidance on distinguishing de facto indemnification from separate tort claims, we turn to *First Golden Bancorporation v. Weiszmann.*[24]

¶ 24 First Golden Bancorporation sued Weiszmann for recovery of profits he made through short-swing trades in violation of section 16(b).[25] Weiszmann, in turn, brought third party claims against Morgan Stanley, which had acted as Weiszmann's financial advisor during the course of the section 16(b) viola-

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[23] *In re Cendant Corp. Sec. Litig.*, 139 F.Supp.2d 585, 596 (D.N.J.2001).

[24] 942 F.2d 726 (10th Cir.1991).

[25] *First Golden*, 942 F.2d at 728.

tion, and against the purchaser of the stock.[26] He claimed indemnity, as well as a number of state tort claims including outrageous conduct, breach of contract, fraud, and negligent representation.[27] He sought indemnification for any liability to First Golden, reimbursement of attorney fees and costs, and recovery of commissions and profit realized by Morgan Stanley from the sale of the stock.[28]

**122 ¶ 25 The court upheld the dismissal of Weiszmann's indemnity claim, noting that such indemnity contravened the public policy enunciated by the federal securities laws.[29] While Congress felt that the imposition of strict liability was the most effective way to deter fraud, the imposition of strict liability did not minimize the purpose of preventing fraudulent trading based upon insider information or manipulation.[30]

¶ 26 The court then proceeded to analyze Weiszmann's remaining claims to determine whether they constituted de *584 facto indemnification, stating that to the extent that they were disguised indemnity claims, they could not stand.[31] The court drew a distinction between profits which would rightly be disgorged to First Golden, and those which arose separately.[32] Thus, for instance, Weiszmann might properly seek the return of Morgan's commissions and profits from the sale of First Golden stock.

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[26] *First Golden*, 942 F.2d at 728.
[27] *First Golden*, 942 F.2d at 728.
[28] *First Golden*, 942 F.2d at 728.
[29] *First Golden*, 942 F.2d at 728.
[30] *First Golden*, 942 F.2d at 729.
[31] *First Golden*, 942 F.2d at 731-32.
[32] *First Golden*, 942 F.2d at 731.

We note that the $112,260 sum at issue in these remaining claims is not part of First Golden's claims against Weiszmann because the profit made by the third-party defendants is clearly not profit inuring to Weiszmann through his sale of First Golden stock. Therefore, because First Golden never had a right to this $112,260, Weiszmann may be able to characterize this portion of his third-party claims as non-indemnity claims.[33]

¶ 27 The court held that the profits and commissions the third parties earned off the sale of Weiszmann's stock were clearly not recoverable by First Golden in its original section 16(b) action, and to that extent Weiszmann's claims may not have been de facto indemnity claims.[34]

¶ 28 The court then remanded to the district court to review the claims and determine whether and to what extent they sought relief other than indemnification.[35] The court instructed the district court that to the extent any of the claims were indemnification claims for liability that Weiszmann incurred under section 16(b), they should be dismissed with prejudice.[36]

¶ 29 The *First Golden* court's analysis is reinforced by the recent holding in *585*Deephaven Capital Mgmt., LLC v. Schnell*.[37] Deephaven sued Schnell, one of its portfolio managers, alleging that Schnell's

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[33] *First Golden*, 942 F.2d at 731.
[34] *First Golden*, 942 F.2d at 732.
[35] *First Golden*, 942 F.2d at 732.
[36] *First Golden*, 942 F.2d at 732.
[37] No. 06-844, 2007 WL 38911, 2007 U.S. Dist. LEXIS 1504 (Jan. 5.2007).

trading activities on behalf of funds he managed caused the funds to violate section 16(b).[38] The court held that any indemnity for section 16(b) violations would undermine the deterrent purpose of the section by allowing a wrongdoer to recoup its disgorged profits. It concluded that Deephaven was not entitled to seek reimbursement for short-swing profits it disgorged, even when the losses resulted from allegedly rogue trades by one of its own managers.[39]

¶ 30 The *First Golden* court remarked that strict liability did not minimize the purpose behind the securities statute.[40] If anything, that understates the case. Section 16(b) is draconian. By imposing strict liability, Congress has given notice to insiders that they should exercise great vigilance in the disposition of their shares. The necessity of protecting investors is no less compelling today than it was when Congress wrote the securities act. To allow indemnification or de facto indemnification by an insider would run **123 counter to the public policy behind section 16(b).

¶ 31 The *First Golden* court's analysis of de facto indemnity is persuasive. Under its holding, to whatever extent funds recovered under a state tort claim are comparable to the funds disgorged under section 16(b), they must be barred as de facto indemnification.

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[38] *Deephaven*, 2007 WL 38911, 2007 U.S. Dist. LEXIS 1504, at *1-3.

[39] *Deephaven*, 2007 WL 38911, 2007 U.S. Dist. LEXIS 1504, at *8-10.; Peter J. Romeo & Alan L. Dye, Section 16 Deskbook 371 (2007).

[40] *First Golden*, 942 F.2d at 729.

[6] ¶ 32 The Jains listed equitable indemnity as one of their causes of action. They seek reimbursement by the respondents for the costs and damages resulting from the judgment and settlement in the 16(b) suit, the attorney fees they expended in defending the section 16(b) action, and the investment losses they claim to have suffered in connection *586 with the bonding requirements for their appeal of the section 16(b) action.

¶ 33 The Jains' request for equitable indemnification reinforces the respondents' contention that the Jains' claims are merely requests for de facto indemnification in a different guise.

¶ 34 The Jains argue that dismissal of their state tort claims might shield securities professionals from the consequences of their negligence and malpractice. Certainly the state has a strong interest in enforcing its tort laws. Brokers, financial advisors, and lawyers should be answerable in state court for harms they have caused their clients. But, to the extent that state claims constitute any form of indemnification, the strict liability provisions of section 16(b) would be fatally undermined were insiders able to pursue those claims, however named, against third parties. To permit such claims to proceed would essentially make the insiders whole again, as if they had not been obliged to disgorge their profits in the first place.

¶ 35 The Supreme Court made clear that section 16(b)'s arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic ef-

fect.[41] Only by exercising uncompromising rigidity can the courts maintain the prophylactic standard of behavior imposed by section 16(b).[42]

¶ 36 The Jains' argument that the state has an interest in allowing their claims to proceed under separate and distinct legal theories must ultimately give way to the bright line, strict liability provisions of section 16(b). We hold that because they seek recovery of the profits they were required to disgorge to InfoSpace, the Jains' claims constitute de facto indemnification and present an insuperable bar to relief. To the extent the Jains raise other claims, *587 they are governed by state law. Because we hold the Jains' claims are barred, we do not address Perkins's cross-appeal.

The ABC rule

[7] ¶ 37 In addition to being barred as de facto indemnity, the Jains' claims also fail to satisfy the requirements of Washington's "ABC rule."

[8] ¶ 38 The general rule in Washington is that attorney fees are not awarded unless permitted by contract, statute, or in specific equitable circumstances.[43] One such equitable exception is the so-called "ABC rule," which allows an award of attorney fees as consequential damages.[44]

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[41] *Reliance*, 404 U.S. at 422, 92 S.Ct. 596 (quoting *Bershad*, 428 F.2d at 696).

[42] *Volk v. Zlotoff*, 285 F.Supp. 650, 656 (D.C.N.Y.1968) (quoting *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928)).

[43] *Morgan v. Roller*, 58 Wash.App. 728, 730, 794 P.2d 1313 (1990).

[44] *Manning v. Loidhamer*, 13 Wash.App. 766, 769, 538 P.2d

¶ 39 However, we have consistently held that a party may not recover attorney fees or costs of litigation under the theory of equitable indemnity if, in addition to the wrongful act or omission of A, there are other reasons why B became involved in litigation with C.[45] "[T]he critical inquiry under the causation element of equitable indemnity is whether, apart from A's actions, B's own conduct caused it to be 'exposed' or 'involved' in litigation with C."[46]

**124 ¶ 40 The Jains were not blameless in the transactions giving rise to their liability. The district court laid out how the Jains' own actions caused them to run afoul of section 16(b):

> The Jains signed papers allowing transfer of funds from the [trusts]. The Jains caused deposits of trust stock into their personal brokerage accounts by forwarding stock certificates to their personal broker. Mr. Jain promised to place shares of the ... trust into escrow to fulfill a personal obligation. The fact that the Jains failed to read their brokerage statements, simply signed legal documents without knowing what they were, and *588 mistakenly sent certificates to their personal broker does not make their actions involuntary.... [T]he Jains participated in the transfers and retained more than a degree of control over the transactions. Without the participation of the Jains, the transfers would not have happened.

136, 86 Wash.2d 1001 (1975).

[45] *Tradewell Group, Inc. v. Mavis*, 71 Wash.App. 120, 126, 857 P.2d 1053 (1993).

[46] *Tradewell Group*, 71 Wash.App. at 129, 857 P.2d 1053.

¶ 41 We hold that the Jains' own conduct caused them to be involved in the litigation and, therefore, under the ABC rule they may not recover fees or litigation costs.

¶ 42 The superior court's grant of the respondents' motions to dismiss is affirmed.

¶ 43 AFFIRMED.

I CONCUR: COLEMAN, J. Pro Tem.APPELWICK, C.J. (concurring).

¶ 44 I concur in the reasoning and result reached by the majority. The majority opinion tacitly acknowledges the Jain's claims for attorney fees were not extinguished by section 16(b)

¶ 45 I would however explicitly hold that section 16(b) of the Securities Exchange Act of 1934 [FN1] is not a bar to malpractice claims under state tort law. Rather the act limits the relief available under those claims by precluding indemnification for profits disgorged for violation of the act. The unavailability of indemnity will be dispositive of claims in some cases, but not necessarily all.

FN1. Codified at 15 U.S.C.A. § 78p.(b).

Wash.App. Div. 1,2008.
Jain v. J.P. Morgan Securities, Inc.
142 Wash.App. 574, 177 P.3d 117

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APPENDIX C

HONORABLE RICHARD JONES

IN THE SUPERIOR COURT OF WASHINGTON
FOR KING COUNTY

NAVEEN JAIN and ANURADHA JAIN, Plaintiffs, vs. J.P. MORGAN SECURITIES, INC., a Delaware corporation, as successor in interest to Hambrecht & Quist LLC; and WILSON SONSINI GOODRICH & ROSATI, a California professional corporation, Defendants.	CONSOLIDATED NO. 03-2-32427-2 SEA [Consolidated with 03-2-34789-2 SEA and 04-2-1655-0 SEA] ORDER GRANTING DEFENDANT J.P. MORGAN SECURITIES, INC.'S MOTION TO DISMISS
NAVEEN JAIN and ANURADHA JAIN, Plaintiffs, vs. PERKINS COIE LLP, Defendant.	

Before this Court is Defendant J.P. Morgan Securities, Inc.'s Motion to Dismiss. In connection with this motion, the Court has reviewed the following materials:

1. Defendant J.P. Morgan Securities, Inc.'s Motion to Dismiss;

2. Defendant J.P. Morgan Securities, Inc.'s Request for Judicial Notice in Support of Defendant J.P. Morgan Securities, Inc.'s Motion to Dismiss;

3. Consolidated Opposition of Naveen and Anuradha Jain to Motions to Dismiss by Wilson Sonsini Goodrich and Rosati, P.C. and J.P. Morgan Securities, Inc.;

4. The Declaration of Timothy Leyh In Support of the Consolidated Opposition of Naveen and Anuradha Jain to Motions to Dismiss by Wilson Sonsini Goodrich and Rosati, P.C. and J.P. Morgan Securities, Inc.;

5. Defendant J.P. Morgan Securities, Inc.'s Reply to Opposition to Motion to Dismiss Third Amended Complaint;

6. Defendant J.P. Morgan Securities, Inc.'s Request for Judicial Notice in Support of Defendant J.P. Morgan Securities, Inc.'s Reply to Opposition to Motion to Dismiss Third Amended Complaint;

7. Non-Washington Authorities cited in Defendant J.P. Morgan Securities, Inc.'s Reply to Opposition to Motion to Dismiss Third Amended Complaint.

The Court has also reviewed the records and files herein, including plaintiffs' Third Amended Complaint, and has considered the arguments of counsel at a hearing before this Court on April 28, 2006.

Being advised in this matter, the Court hereby finds that the Third Amended Complaint fails to state a claim upon which relief can be granted against defendant J.P. Morgan Securities, Inc. It is hereby ORDERED that defendant J.P. Morgan Securities, Inc.'s Motion to Dismiss is GRANTED, and that plaintiffs' Third Amended Complaint is dismissed with prejudice.

IT IS SO ORDERED.

DATED this 5th day of May, 2006.

/s/ Richard A. Jones
JUDGE RICHARD JONES

Presented by:

HILLIS CLARK MARTIN & PETERSON PS

By /s/ Michael R. Scott
Michael R. Scott, WSBA #12822
Brian C. Free, WSBA #35788

BINGHAM MCCUTCHEN LLP
David M. Balabanian (admitted *pro hac vice*)
John D. Pernick (admitted *pro hac vice*)
3 Embarcadero Center
San Francisco, CA 94111
Telephone: (415) 393-2000

Attorneys for J.P. Morgan Securities Inc.

Notice of Presentation Waived; Accepted as to Form:

DANIELSON HARRIGAN LEYH &
TOLLEFSON LLP

By /s/ Michael R. Scott

Arthur W. Harrigan, Jr., WSBA #1751
for Timothy G. Leyh, WSBA #14583 pursuant to email authorization
Randall T. Thomsen, WSBA #25310
999 Third Avenue, Suite 4400
Seattle, WA 98104
Telephone: (206) 623-1700

LANE POWELL PC
Larry Ganges, WSBA #8118
John R. Neeleman, WSBA #19752
1420 Fifth Avenue, Suite 4100
Seattle, WA 98101-2338
Telephone: (206) 223-7000

LAW OFFICES OF ROBERT B. GOULD
Robert B. Gould, WSBA #4353
2110 North Pacific Street, Suite 100
Seattle, WA 98103-9181
Telephone: (206) 633-4442

Attorneys for Plaintiff

Hon. Richard A. Jones

SUPERIOR COURT OF WASHINGTON FOR KING COUNTY

NAVEEN JAIN and ANURADHA JAIN, Plaintiffs, vs. J.P. MORGAN SECURITIES, INC., a Delaware corporation, as successor in interest to Hambrecht & Quist LLC; and WILSON SONSINI GOODRICH & ROSATI, a California professional corporation, Defendants.	Consolidated No. 03-2-32427-2 SEA [Consolidated with 03-2-34789-2 SEA and 04-2-1655-0SEA] ORDER GRANTING WILSON SONSINI'S MOTION TO DISMISS THIRD AMENDED COMPLAINT

Pending before this Court is defendant Wilson Sonsini Goodrich and Rosati's Motion to Dismiss Third Amended Complaint. In connection with this motion, the Court has reviewed the following materials:

1. Defendant Wilson Sonsini Goodrich and Rosati's Motion to Dismiss Third Amended Complaint;

2. Declaration of Gregory J. Hollon in Support of Wilson Sonsini Goodrich and Rosati's Motion to Dismiss Third Amended Complaint and Exhibits A-C attached thereto;

3. Consolidated Opposition of Naveen and Anuradha Jain to Motions to Dismiss by Wilson Sonsini Goodrich and Rosati, P.C. and J.P. Morgan Securities, Inc.;

4. Declaration of Timothy G. Leyh in Support of the Consolidated Opposition of Naveen and Anuradha Jain to Motions to Dismiss by Wilson Sonsini Goodrich and Rosati, P.C. and J.P. Morgan Securities, Inc. and the exhibits attached thereto;

5. Defendant Wilson Sonsini Goodrich and Rosati's Reply in Support of Opposition to Motion to Dismiss Third Amended Complaint;

6. Jains' Request for Leave to File Surreply to New Argument in Wilson Sonsini Goodrich and Rosati's Reply in Support of Motion;

7. Defendant Wilson Sonsini's Opposition to Plaintiff's Request for Leave to File Surreply; and

8. The Jains' Reply in Support of Request for Leave to File Surreply to New Argument in Wilson Sonsini Goodrich and Rosati's Reply in Support of Motion and Jains' Surreply;

9. Wilson Sonsini's Reply to Surreply.

The Court has also reviewed the records and files herein, including plaintiffs' Third Amended Complaint, and has considered the arguments of counsel at a hearing before this Court on April 28, 2006.

Being advised in this matter, the Court hereby finds that the Third Amended Complaint fails to state a claim upon which relief can be granted against defendant Wilson Sonsini. It is hereby ORDERED that defendant Wilson Sonsini Goodrich and Rosati's Motion to Dismiss is

GRANTED, and that plaintiffs' Third Amended Complaint is dismissed with prejudice.

IT IS SO ORDERED.

DATED this 4th day of May, 2006.

/s/ Richard A. Jones
HONORABLE RICHARD JONES

Presented by:
McNAUL EBEL NAWROT & HELGREN PLLC

By /s/ Robert M. Sulkin
Robert M. Sulkin, WSBA #15425
Gregory J. Hollon, WSBA #26311

Attorneys for Defendant Wilson Sonsini Goodrich & Rosati, P.C.

Approved as to form
/s/ Timothy G. Leyh

The Honorable Richard Jones

SUPERIOR COURT OF WASHINGTON FOR KING COUNTY

NAVEEN JAIN and ANURADHA JAIN, husband and wife, and their Maritial Community,

Plaintiffs,

vs.

J.P. MORGAN SECURITIES, INC., a Delaware corporation, as successor in interest to Hambrecht & Quist LLC, *et al,*

Defendants.

NAVEEN JAIN and ANURADHA JAIN,

Plaintiffs,

vs.

PERKINS COIE LLP,

Defendant.

Case No. 03-2-32427-2 SEA

[Consolidated with 03-2-34789-2 SEA and 04-2-1655-0 SEA]

ORDER GRANTING PERKINS COIE'S MOTION TO DISMISS PLAINTIFFS' SECOND AMENDED COMPLAINT AND DENYING PLAINTIFFS' MOTION FOR PARTIAL SUMMARY JUDGMENT

This matter came for hearing on the motion of Perkins Coie LLP ("Perkins") to dismiss the Second Amended Complaint filed against it by plaintiffs Naveen and Anuradha Jain ("Plaintiffs"), and Plaintiffs' Motion for Partial Summary Judgment Striking Perkins Coie's Affirmative Defense of Federal Preemption With Respect to Plaintiffs' Litigation Malpractice Claims. The Court has reviewed the records submitted in regard to these motions, including but not limited to the following:

1. Perkins Coie's Motion to Dismiss Second Amended Complaint;

2. Declaration of Keith D. Petrak, Including Request for Judicial Notice in Support of Perkins Coie's Motion to Dismiss Second Amended Complaint;

3. Defendant J.P. Morgan Securities, Inc.'s Motion to Dismiss;

4. Defendant J.P. Morgan Securities, Inc.'s Request for Judicial Notice in Support of Defendant J.P. Morgan Securities, Inc.'s Motion to Dismiss;

5. Defendant Wilson Sonsini Goodrich and Rosati's Motion to Dismiss Third Amended Complaint;

6. Declaration of Gregory J. Hollon in Support of Wilson Sonsini Goodrich and Rosati's Motion to Dismiss Third Amended Complaint and Exhibits A-C attached thereto;

7. Consolidated Opposition of Naveen and Anuradha Jain to Motions to Dismiss by Wilson

Sonsini Goodrich and Rosati, P.C. and J.P. Morgan Securities, Inc.;

8. December 2, 2005 Order Denying Plaintiffs Motion: (1) To Strike Perkins Motion to Dismiss Litigation Malpractice Claims; and/or (2) To Strike Extra-Pleading Materials Presented in Support of That Motion; and/or (3) For a CR 56(f) Continuance of Motion Hearing until Following Completion of Expert Deposition Discovery; And Denying Plaintiffs Motion for Extension of Time to Respond to Perkins Coie's Motion to Dismiss Litigation Malpractice Claims

9. Defendant J.P. Morgan Securities, Inc.'s Reply to Opposition to Motion to Dismiss Third Amended Complaint;

10. Wilson Sonsini Goodrich and Rosati's Reply in Support of Motion to Dismiss Third Amended Complaint;

11. Plaintiff Jains' Opposition to Perkins to These Motion to Dismiss;

12. Plaintiffs, Motion for Partial Summary Judgment Striking Perkins Cooties Affirmative Defense of Federal Preemption with Respect to Plaintiffs' Litigation Malpractice Claims;

13. Plaintiffs' Offer of Intended and/or Hypothetical Proof Re: Proximate Cause Arguments Made in Perkins Motion to Dismiss;

14. Declaration of Robert J. Adolf;

15. Declaration of John A. Strait In Support of Jains' Motion to Strike, etc.;

16. Perkins Coie's Consolidated Reply in Support of Motion to Dismiss Second Amended Complaint and Opposition to Plaintiff's Motion for Partial Summary Judgment;

17. Plaintiffs' Reply in Support of Motion for Partial Summary Judgment Striking Perkins Coie's Affirmative Defense of Federal Preemption with Respect to Plaintiffs Litigation Malpractice Claims;

18. May 2, 2006 Letter from Larry Gagnes; and

19. May 3, 2006 letter from Bradley S. Keller.

Having considered the foregoing record and the arguments of counsel, and finding as a matter of law that Plaintiffs' Second Amended Complaint for Damages and Other Relief against Perkins fails to state a claim upon which relief may be granted, and that further amendment would be futile, it is hereby

ORDERED, ADJUDGED AND DECREED that Plaintiffs' motion is denied, Perkins' motion is granted, and Plaintiffs' claims against Perkins as set forth in Plaintiffs' Second Amended Complaint for Damages and Other Relief are hereby dismissed with prejudice.

DATED this 4th day of May, 2006.

/s/ Richard A. Jones
THE HONORABLE RICHARD JONES

Presented by:

BYRNES & KELLER LLP

By /s/ Keith D. Petrak

Peter D. Byrnes, WSBA #00446
Bradley S. Keller, WSBA #10665
Keith D. Petrak, WSBA #19159
Attorneys for Defendant
Perkins Coie, LLP

APPENDIX D

United States District Court, W.D. Washington.
Naveen and Anuradha JAIN, Plaintiffs,
v.
INFOSPACE, INC, et al., Defendants.
No. C03-2897P.

Filed Sept. 23, 2003.
Jan. 9, 2004.

represented by G. Val Tollefson, Danielson Harrigan & Tollefson, Seattle, WA, Lead Attorney, Attorney to be Noticed, John R Neeleman, Larry Steven Gangnes, Lane Powell Spears Lubersky, Seattle, WA, Lead Attorney, Attorney to be Noticed, Timothy G Leyh, Danielson Harrigan & Tollefson, Seattle, WA, Lead Attorney, Attorney to be Noticed, Randall Thor Thomsen, Danielson Harrigan & Tollefson, Seattle, WA, Attorney to be Noticed, for Naveen Jain, Plaintiff.
represented by G. Val Tollefson, John R Neeleman, Larry Steven Gangnes, Timothy G Leyh, (See above for address), Lead Attorney, Attorney to be Noticed, for Anuradha Jain, husband and wife, and the Marital Community, Plaintiff.
represented by Brian D Buckley, Stellman Keehnel, Gray Cary Ware & Freidenrich LLP, Seattle, WA, Lead Attorney, Attorney to be Noticed, for InfoSpace Inc, a Delaware corporation, Defendant.
represented by Brian D Buckley, Stellman Keehnel, (See above for address), Lead Attorney, Attorney to be Noticed, for Mellon Investor Services LLC, a New Jersey corporation, as successor in interest to ChaseMellon Shareholder Services, LLC, Defendant.
represented by David M Balabanian, McCutchen

Doyle Brown & Enersen, San Francisco, CA, Lead Attorney, Attorney to be Noticed, John D Pernick, Bingham Mccutchen (SF), San Francisco, CA, Lead Attorney, Attorney to be Noticed, Michael Ramsey Scott, Hillis Clark Martin & Peterson, Seattle, WA, Lead Attorney, Attorney to be Noticed, for JP Morgan Securities Inc, a Delaware corporation as successor in interest to Hambrecht & Quist LLC, Defendant.
represented by Brian D Buckley, Stellman Keehnel, (See above for address), Lead Attorney, Attorney to be Noticed, for Ellen Alben, Defendant.
represented by Brian D Buckley, Stellman Keehnel, (See above for address), Lead Attorney, Attorney to be Noticed, for Alex Alben, and their Marital Community, Defendant.

ORDER GRANTING PLAINTIFFS' MOTION TO REMAND

PECHMAN, J.
*1 This matter comes before the Court on Plaintiffs' motion to remand. (Dkt. No. 6.) Having reviewed all of the pleadings and supplemental materials and having heard oral argument on the matter, the Court GRANTS Plaintiffs' Motion to Remand. Defendants argue that the Plaintiffs' ("the Jains") state law tort claims are really claims for reimbursement or indemnification of the Jains' Section 16(b) liability under the Securities and Exchange Act ("the SEA" or "the Act"). According to Defendants, federal law bars indemnification for Section 16(b) liability. Based on this, Defendants maintain that there is removal jurisdiction under the artful pleading doctrine. However, Defendants have failed to meet the requirements of the artful pleading doctrine. The Jains'

claims are not necessarily federal in character. Nor is a federal question an element of their state law tort claims. Instead, Defendants' argument is properly characterized as a defense based on a federal question. As a defense, it cannot provide the basis for removal jurisdiction.

BACKGROUND

This case stems from the *Dreiling v. Jain* case ("the *Dreiling* litigation"), C01-1528P. On May 14, 2003, this Court entered summary judgment against the Jains, concluding that they had engaged in prohibited short-swing trading in violation of Section 16(b) of the SEA. On August 22, this Court entered judgment against the Jains, ordering them to disgorge the profits from these trades, totaling approximately $200 million dollars plus prejudgment interest.

In August, the Jains filed this law suit in state court against two securities firms that worked with Infospace, Infospace's general counsel, and Infospace. The Jains claim that all of these Defendants were negligent and breached their fiduciary obligations to the Jains, which caused the damages that the Jains incurred as a result of the *Dreiling* litigation. They also seek equitable subrogation against all Defendants, and claim unjust enrichment against Infospace.

Defendants removed the Jains' D & O insurers suit. In their removal notice, Defendants claimed that the federal district court has removal jurisdiction because "plaintiffs' claims implicate and depend upon a substantial federal question.... [T]he Jains' claims

depend upon whether indemnity is available for Section 16(b) liability. The federal case law is clear that Section 16(b) liability cannot be indemnified."(Notice of Removal, ¶ 3)

ANALYSIS

The removal statute is strictly construed against removal jurisdiction. *Gaus v. Miles, Inc.,* 980 F.2d 564, 566 (9th Cir.1992)."Federal jurisdiction must be rejected if there is any doubt as to the right of removal in the first instance."*Id.* The removing party has the burden of proof that removal was proper. *Id*. When removal is premised on a federal question, the removing party must establish the federal nature of the claim.

Removal analysis begins with the well-pleaded complaint rule, in which federal question jurisdiction exists only when a federal question is present on the face of the plaintiff's properly plead complaint. *Rivet v. Regions Bank of La.,* 522 U.S. 470, 475 (1998) (citing *Caterpillar Inc. v. Williams,* 482 U.S. 386, 392 (1987)). Moreover, a plaintiff may defeat removal by choosing not to plead independent federal claims. *ARCO Envtl. Remediation v. Dep't of Health and Envtl. Quality,* 213 F.3d 1108, 1114 (9th Cir.2000). Both parties agree that neither of the complaints in these actions explicitly set forth a federal cause of action.

*2 Nonetheless, Defendants argue that this Court has removal jurisdiction under the artful pleading doctrine. A plaintiff may not defeat removal of a federal claim by artfully pleading it as a state claim or omitting to plead necessary federal questions. *Rivet,*

522 U.S. at 475,*Franchise,* 22. The artful pleading doctrine applies when either 1) federal law completely preempts state law, 2) the claim is necessarily federal in character, or 3) the right to relief depends on the resolution of a substantial, disputed federal question. *ARCO,* 213 F.3d at 1114. (A recent Ninth Circuit opinion combined 2) and 3) into one standard, with two sub-parts. *Lippitt v. Raymond James Fin. Servs.,* 340 F.3d 1033, 1041-42 (9th Cir.2003). This appears to be merely a semantic difference .) Both parties agree that the SEA does not completely preempt the field.

However, Defendants contend that the Jains' claims are necessarily federal in character and that the Jains' right to relief depends on resolution of a substantial, disputed federal question. The Defendants' two arguments stem from their basic premise that the Jains' claims are really claims for reimbursement or indemnification disguised as state law claims. Defendants cite a Tenth Circuit case for the proposition that the SEA prohibits indemnification for Section 16(b) liability. *First Golden Bancorporation v. Weiszmann,* 942 F.2d 726 (10th Cir.1991). Therefore, according to Defendants, the Jains must show that their Section 16(b) liability can be indemnified. In other words, indemnification for Section 16(b) liability is a condition precedent to Jains' state law claims.

In contrast, if a defendant's basis for removal jurisdiction is a federal question defense, as opposed to an affirmative federal claim that plaintiff disguised as a state law claim, there is no removal jurisdiction. It is settled law that a defense based on a federal question does not establish federal jurisdiction. This

is true "even if the defense is anticipated in the plaintiff's complaint and both parties agree that the defense is the only question truly at issue in the case." *Franchise Tax Bd. of Cal. v. Constr. Laborers Vacation,* 463 U.S. 1, 14 (1983)."A defense is not part of a plaintiff's properly pleaded statement of his or her claim." *Rivet,* 522 U.S. at 475. The Jains contend that Defendants' argument is a federal question defense.

I. The Jains' Claims Are Not Necessarily Federal in Character

Defendants' "necessarily federal" argument rests on two provisions of the SEA. First, Section 16(b) liability cannot be waived or altered by agreement. 15 U.S.C. § 78cc(a). Second, federal courts have exclusive jurisdiction over all suits "brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." § 78aa. According to Defendants, Plaintiffs' claims, which are really an attempt to seek reimbursement or indemnification for their Section 16(b) liability, undermine the prohibition on waiving or altering liability by agreement. In essence, Defendants argue that by seeking reimbursement or indemnification from the securities firms and Infospace for the Jains' Section 16(b) liability, the Jains would be escaping their Section 16(b) liability, or "shifting their entire 16(b) liability onto Defendants," in violation of § 78cc(a). Moreover, by doing so, they are attempting to escape enforcement of their Section 16(b) liability. This challenge to the enforcement of Section 16(b) liability triggers the exclusive jurisdiction provision in § 78aa.

*3 A similar issue was addressed by the Ninth Cir-

cuit in *Lippitt.*The plaintiff alleged that marketing by brokerage firms of a "callable certificate of deposit" violated state unfair competition laws. Defendant claimed that the exclusive federal jurisdiction provision in § 78aa of the SEA supported removal jurisdiction. 340 F.3d at 1036. The Ninth Circuit rejected this argument. The court held that plaintiff's claims did not fall within the scope of § 78aa because plaintiff was not attempting to enforce any provision of the Act. Rather, he sought to enforce state law. *Id.* at 1037.

Like the plaintiff in *Lippitt,* the Jains' claims do not touch upon the enforcement of their Section 16(b) liability. They are not seeking through this lawsuit to challenge their Section 16(b) liability or to escape enforcement of their Section 16(b) liability. In fact, the Jains' Section 16(b) liability is the premise upon which their state law claims rest. If they were challenging the validity of their Section 16(b) liability, they could not allege negligence by Infospace, its general counsel, and two securities firms for "causing" that liability. This lawsuit does not challenge the liability itself; success on the merits would not negate the fact that they were held strictly liable for Section 16(b) violations. Instead, the Jains are merely seeking to hold other parties accountable for negligence in causing the damages they incurred as a result of their Section 16(b) liability. Like the plaintiff in *Lippitt,* the Jains' state law claims do not fall within the scope of the Act. As such, the exclusive jurisdiction provision of § 78aa is not triggered. Defendants' argument that the Jains are directly challenging a right or liability under the SEA mischaracterize the Jains' claims.

The Court does not find *Bunker Ramo-Electra Corp. v. Fairchilds Industries, Inc.* persuasive on this issue. 639 F.Supp. 409 (D.Md.1986). That court held in dicta that indemnification for Section 16(b) liability would violate § 78cc because it would allow the violators to waive their Section 16(b) liability "since they would not have to return their short-swing profits...." *Id.* at 419.First, the Jains have alleged negligence, not indemnification. Despite the fact that the result be the same, these are legally distinct causes of action. Second, the Jains must disgorge their short-swing profits regardless of whether they can prove as a matter of law and fact that the Defendants were negligent, causing the damages the Jains incurred in the *Dreiling* litigation. They are not waiving their Section 16(b) liability.

Defendants' reliance on *ARCO* is equally misplaced. In determining whether a claim is necessarily federal in character, *ARCO* looked to the language of the federal statute upon which the defendant premised removal jurisdiction. 213 F.3d at 1115. Like the SEA, the federal statute at issue in *ARCO,* the Comprehensive Environmental Responsibility, Compensation, and Liability Act (the Superfund legislation), conferred exclusive federal jurisdiction in limited circumstances. Under this Act, exclusive federal jurisdiction existed when a plaintiff's claims challenged a Superfund cleanup. The court held that an action challenged Superfund cleanup if the action was related to the goals of the cleanup. Plaintiff sought disclosure of certain cleanup documents. As such, the plaintiff's claim was not related to Superfund cleanup goals. Therefore, plaintiff's claim was not necessarily federal in character. *Id.* Defendants seize upon this language and argue that, unlike the

plaintiff's claims in *ARCO,* the Jains' claims directly challenge the goals of Section 16(b) liability by seeking to pass their liability on to other parties, in violation of § 78cc. However, the Jains' claims do not directly challenge the strict liability goal of Section 16(b). As discussed above, their Section 16(b) liability is the premise of their state law claims. Prevailing on their state law claims would not negate the fact that they were deemed liable under Section 16(b).

*4 For this reason, this is case is not analogous to *Gilson v. Chock Full O'Nuts Corp.* 331 F.2d 107 (2d Cir.1964). In *Gilson,* the Second Circuit concluded that awarding attorney's fees to shareholder's counsel who brought a Section 16(b) violation to the attention of the corporation was within the scope of the Act because it was a remedy incidental to the federal right created by Section 16(b). Unlike attorney's fees, which are appropriately deemed instrumental to the enforcement of Section 16(b), barring a person found liable under Section 16(b) from alleging negligence against another for causing the Section 16(b) damages incurred is not instrumental to the enforcement of Section 16(b). While it may or may not undermine the policy behind Section 16(b), that argument is more appropriately characterized as a federal question defense.

II. Federal Law Is Not an Element of the Jains' State Law Claims

Under the third prong of the artful pleading doctrine, federal jurisdiction exists over a state law claim if the right to relief depends on the resolution of a substantial, disputed federal question. In analyzing a state claim under this prong, both *Lippitt*

and *ARCO* look to whether a substantial, disputed question of federal law is a *necessary element* of the plaintiff's state law claim. Without this requirement, it would be difficult to impossible to determine when an issue is a substantial and disputed federal question supporting removal jurisdiction versus when an issue is a defense that happens to raise a substantial and disputed federal question upon which the merits of the case may turn, but which cannot support removal jurisdiction. The law is clear that a federal question defense cannot support removal jurisdiction, no matter how central it is to the resolution of plaintiff's claims, nor how novel or complex the federal question may be. *Rivet,* 522 U.S. at 475, *Franchise Tax Bd.,* 463 U.S. at 14. Without a clear and systematic way of distinguishing an artfully plead federal claim from a federal question defense, resolution of the kinds of questions presented in this motion would lead to inconsistent and seemingly random results wherein removal jurisdiction would sometimes exist but not others. The necessary element requirement provides a clear and systematic way to distinguish the two. In *Lippitt,* the court reviewed the elements of plaintiff's state law unfair competition claim, finding that "his allegations [were] sufficient ... to sustain the elements of his [unfair competition] claim without resort to federal law." 340 F.3d at 1043. In *ARCO,* the court held that the plaintiff's right to relief seeking disclosure of state agency documents was not predicated on federal law. 213 F.3d at 1116. Like these two cases, federal law is not a necessary element of the Jains' claims in either of their complaints.

The Jains allege that two securities firms, Infospace's general counsel, and Infospace were negligent

and breached their fiduciary duties in handling the transactions that lead to the short-swing purchases. The Jains' claims against these Defendants rests solidly in tort law. Defendants argue that the Jains' claims in this case are indemnity or reimbursement claims in disguise. However, Defendants have presented no authority indicating that the elements of negligence and breach of fiduciary duty are the same as those for indemnification. Indemnity is defined as "a duty to make good any loss, damage, or liability incurred by another; the right of an injured party to claim reimbursement for its loss, damage, or liability from a person who has such a duty; reimbursement or compensation for loss, damage, or liability in tort...." *Black's Law Dictionary* (7th ed.1999). Thus, it seems that a claim for indemnification or reimbursement only requires showing that the Defendants had an obligation to "make good" or reimburse the Jains and have failed to fulfill that obligation. The Jains have not alleged this. They have alleged negligence and breach of fiduciary duty, which requires them to show that the Defendants owed the Jains a duty of care, the Defendants breached that duty, and the breach was the actual and proximate cause of damages suffered by the Jains. While the ultimate outcome might be the same if the Jains prevail on their state law claims-i.e. the Jains will recover the amount of damages they incurred as Section 16(b) liability-this does not mean that the Jains' negligence and breach of fiduciary duty state law claims are equivalent to claims for indemnification or reimbursement.

*5 Defendants argue that two of the elements of the Jains' negligence claims depend on federal law, namely causation and damages. According to Defen-

dants, only insider-traders can be the legal cause of Section 16(b) liability. Therefore, the Jains must prove that Defendants were the legal cause of their Section 16(b) liability. This mischaracterizes the Jain's claims. The Jains are not claiming that the Defendants caused their liability, but rather that the Defendants caused the prohibited short-swing purchases, which lead to the assignment of Section 16(b) liability. Similarly, Defendants argue that the Jains have not suffered legally-cognizable damages because they were never entitled to the short-swing profits in the first place. However, contrary to Defendant's argument, the Jains' damages are an established fact based on the judgment in the *Dreiling* litigation. Defendants argument that such damages are not legally cognizable is a defense to the damage element that the Jains must prove. The Court notes that state court judges commonly rule on complex and novel issues of federal law. There is no reason to suggest that only federal court judges have the ability to decide the issues presented in this case.

Lastly, *ARCO'* s analysis of the necessary element requirement provides further support for this Court's conclusion. In holding that the plaintiff's claims was not predicated on federal law, the court distinguished two cases where federal question jurisdiction existed for state law claims, both of which are equally distinguishable here. 213 F.3d at 1116. In one, an element of the plaintiff's state law tort claim was the breach of a duty created by federal law. *Sable v. General Motors Corp.*, 90 F.3d 171 (6th Cir.1996). In the other, an element of the plaintiff's state law breach of warranty claim was an agreement created by federal law. *Marcus v. AT & T,* 138 F.3d 46 (2d Cir.1998). Here, the contract providing

for Section 16(b) liability was not created by federal law, regardless of the fact that it covered a federal law violation.

CONCLUSION

Defendants have failed to establish removal jurisdiction under any of the prongs of the artful pleading doctrine. The Jains' state law tort claims are not necessarily federal in character. Nor is a federal question an element of their state law tort claims. Instead, Defendants' argument that the Jains' claims are really claims for reimbursement or indemnification barred by federal law is a federal question defense. As such, it cannot provide the basis for removal jurisdiction. Therefore, the Court GRANTS Plaintiffs' motion to remand.

The clerk is directed to provide copies of this order to all counsel of record.

W.D.Wash.,2004.
Jain v. Infospace, Inc.
Not Reported in F.Supp.2d, 2004 WL 212999 (W.D.Wash.)

APPENDIX E

United States District Court, W.D. Washington.
Thomas R. DREILING, on behalf of INFOSPACE, INC., Plaintiff,
v.
Naveen **JAIN** and Anuradha **Jain**, husband and wife, and their marital community, the **Jain** Family Irrevocable Trust, the Naveen **Jain** Grat No. 1 Trust, and the Anuradha **Jain** Grat No. 1 Trust, Defendants,
and
Infospace, Inc., Nominal Defendant.
No. C01-1528P.

Aug. 22, 2003.

In action seeking disgorgement of profits earned by corporate insiders in short-swing trades, plaintiff filed motion for judgment, and defendants filed motion for partial summary judgment. The District Court, Pechman, J., held that: (1) in calculating short-swing profits required to be disgorged, purchase price of the shares transferred from trust accounts to insiders personal accounts was $0; (2) insiders could not avoid liability for short-swing profits by returning the money to the trusts; and (3) balance of equities favored award of prejudgment interest.

Motions granted in part and denied in part.

***1236** William H. Beaver, Jr., Karr Tuttle Campbell, Seattle, WA, for Naveen Jain Grat No 1 Trust, Defendant.
Beth Ann Colgan, Harry H. Schneider, Jr., Brent Snyder, Perkins Coie, Seattle, WA, for Jain Family

Irrevocable Trust, Defendant.
Timothy P Crudo, Paul H Dawes, David M. Friedmam, Latham & Watkins, San Francisco, CA, Mark Maynes, Stokes Lawrence, Seattle, WA, Kevin Michael Paulich, Wolfstone, Panchot & Block, Seattle, WA, John C. Tang, Aaron Levine & Associates, Washington, DC, for InfoSpace Inc, Interested Party.
Judith A Endejan, Graham & Dunn, Seattle, for Seattle Times Company, Intervenor.
Christine E Gardiner, Karr Tuttle Campbell, Seattle, for Anuradha Jain Grat No 1 Trust, Defendant.
Douglas W Greene, Barry M. Kaplan, Perkins Coie, Seattle, for Kellett Partners LP, Stiles A Kellett, Jr, Defendants.
Arthur W. Harrigan, Jr., G. Val Tollefson, Danielson Harrigan & Tollefson, Seattle, WA, for Anuradha Jain, Defendant.
Jonathan P Meier, Stephen John Sirianni, Richard E. Spoonemore, Sirianni & Youtz, Seattle, WA, for Thomas R Dreiling, Plaintiff.
Elaine L Spencer, Graham & Dunn, Seattle, WA, for Seattle Times Company, Intervenor.

ORDER GRANTING PLAINTIFF'S MOTION FOR ENTRY OF JUDGMENT AND DENYING DEFENDANTS' MOTION FOR PARTIAL SUMMARY JUDGMENT

PECHMAN, District Judge.
The Court having concluded as a matter of law that Defendants are liable for short-swing trades, Plaintiff moves for entry of judgment against Defendants Naveen and Anuradha Jain ("the Jains" or "Jain Defendants"). (Dkt. No. 140.) The Jain Defendants move for partial summary judgment that they engaged in no short-swing trades, and alternatively

that they realized no profit on the trades. (Dkt. No. 196.) Plaintiff moves to strike numerous declarations, exhibits, and briefing by Defendants as impermissibly seeking reconsideration of the Court's prior order on liability. (Dkt. No. 198.) Because Defendants may not attempt to relitigate liability at this stage of the proceeding, Plaintiff's motion to strike is GRANTED in part. Because the Jain Defendants engaged in short-swing trades by transferring for no cost millions of shares from Trust accounts to personal accounts, they are required to disgorge the profit from these trades. Accordingly, Plaintiff's motion for entry of judgment is GRANTED and the Jain Defendants'*1237 motion for partial summary judgment is DENIED.

BACKGROUND

On the parties' stipulation to present the issue of liability to the Court on summary judgment, the Court concluded that the Jain Defendants engaged in prohibited short-swing trades in violation of Section 16(b) of the 1934 Securities and Exchange Act, 15 U.S.C. § 78p(b). At issue now is the Jain Defendants' disgorgement of the profit from their short-swing trades, as well as prejudgment interest on that profit. In its prior order, the Court concluded that, in December 1998, Mr. Jain purchased, for the purposes of Section 16(b), 1,000,000 shares of InfoSpace stock through his agreement to place Trust shares into an escrow account to satisfy a personal obligation. The Court also concluded that, on May 24, 1999, the Jains purchased 2,490,472 shares of InfoSpace stock by transferring these shares from the Trusts to their personal brokerage accounts. There is no dispute regarding the Jains' sale of In-

foSpace stock within six months of the above purchases. On April 6, 1999, the Jains sold 1,000,000 shares of InfoSpace stock, receiving $85,600,000.00. On April 12, 1999, the Jains sold 210,000 shares of InfoSpace stock, receiving $17,955,000.00. On May 13, 1999, the Jains sold 1,800,000 shares of Infospace stock, receiving $98,966,696.05. In light of this Court's prior order, and accounting for stock splits, the Jains within six months purchased more shares than they sold, so that all profits realized from the above sales of $202,551,696.05 must be disgorged.

ANALYSIS

This matter comes before the Court on summary judgment. Summary judgment is not warranted if a material issue of fact exists for trial. *Warren v. City of Carlsbad,* 58 F.3d 439, 441 (9th Cir.1995), *cert. denied,* 516 U.S. 1171, 116 S.Ct. 1261, 134 L.Ed.2d 209 (1996). The underlying facts are viewed in the light most favorable to the party opposing the motion. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). "Summary judgment will not lie if ... the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986).

I. Plaintiff's Motion to Strike

Plaintiff moves to strike: (1) 15 declarations filed by Defendants on June 23, 2003, except for paragraphs 1-5, 16-17, 28, and 29, 44 of the Naveen Jain Declaration; (2) all exhibits to these declarations except for No. 25 to Mr. Jain's Declaration; (3) page 1

through page 11 ln. 10, and page 15 ln. 8 through page 20 ln. 17, of Mr. Jain's opposition to Plaintiff s motion for entry of judgment; (4) the Anuradha Jain and Trusts' opposition to the motion for entry of judgment; and (5) the Jain Defendants' motion for partial summary judgment.

The Court largely agrees with Plaintiff that the majority of Defendants' briefing is an untimely attempt to reconsider this Court's summary judgment order on liability. The Court has already denied reconsideration of liability, and all of the above motions, declarations, and exhibits come outside the ten-day period for reconsideration. Local Rule CR 7(h)(2). Anuradha Jain and the Trusts submit a brief that contests that there was a change in beneficial ownership, even though this issue was decided on summary judgment. Mr. Jain also contends that there is no purchase without an exchange of consideration, even though this was also addressed on summary judgment. Mr. Jain again raises the argument, rejected on reconsideration, that there was no purchase because the ***1238** transactions were rescinded. Defendants make numerous new arguments regarding how trusts are regulated under Washington law, none of which were pled on summary judgment, and none of which are relevant to a determination of liability or damages under Section 16(b). In pari delicto is a new defense to liability that was not pled or argued on summary judgment or reconsideration. In sum, Defendants raise issues already decided, as well as new arguments, well past the date for reconsideration. The Court will not entertain these untimely submissions and allow Defendants to relitigate liability.

The only issue properly before the Court at this time is the question of judgment. Accordingly, Plaintiff's motion to strike is GRANTED in part. The Court strikes the 15 declarations filed by Defendants on June 23, 2003, and all exhibits to these declarations, except for paragraphs 5, 28, and 29 and Exhibit No. 25 of the Naveen Jain Declaration. Pages 1 through 11 ln. 10 and page 15 ln. 20 through page 20 ln. 17 of the Jains' opposition to Plaintiff's motion for entry of judgment are stricken. The Court strikes pages 2 to 11 ln. 6 of Anuradha Jain and the Trust's opposition to Plaintiff's motion for entry of judgment. The Court strikes page 6 ln. 10 to page 10 ln. 4, and page 11 ln. 16 to page 14 ln. 6, of the Jain Defendants' motion for partial summary judgment.

II. Entry of Judgment

[1][2][3] Section 16(b) was enacted for the purpose of preventing the unfair use of information which may have been obtained by a statutory insider through his or her relationship to the issuing corporation. *Kay v. Scientex Corp.*, 719 F.2d 1009, 1012 (9th Cir.1983). Congress recognized that short-swing speculation by stockholders with advance, inside information would threaten the goal of the Securities Exchange Act to insure the maintenance of fair and honest markets. *Id.* Section 16(b) was aimed at protecting the public by preventing directors, officers, and principal stockholders of a corporation from speculating in the stock on the basis of information not available to others. *Id.* (citations and quotations omitted). Under the statute, all profit realized by the short-swing trades is disgorged to the corporation, and the Court may also allow recovery of prejudgment interest. *Whittaker v. Whittaker Corp.*, 639

F.2d 516, 522, 533 (9th Cir.1981), *cert. denied,* 454 U.S. 1031, 102 S.Ct. 566, 70 L.Ed.2d 473 (1981). Section 16(b) is a strict liability statute that "operates mechanically, and makes no moral distinctions, penalizing technical violators of pure heart, and bypassing corrupt insiders who skirt the letter of the prohibition." *Magma Power Co. v. Dow. Chem. Co.,* 136 F.3d 316, 320-21 (2d Cir.1998).

A. Calculating profit

[4] "For the purpose of preventing the unfair use of information which may have been obtained by ... [an insider], any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security ... within any period of less than six months ... shall inure to and be recoverable by the issuer." 15 U.S.C. § 78p(b). "Profit" is understood in its ordinary sense as "the excess of returns over expenditures ... the excess of the price received over the price paid for the goods sold." *S & S. Realty Corp. v. Kleer-Vu Indus., Inc.,* 575 F.2d 1040, 1043 (2d Cir.1978).

[5] In calculating the profit realized as a result of stock purchases, courts use the "lowest purchase price, highest sale price" method. *Whittaker,* 639 F.2d at 530. Under this rule, called the *Smolowe* rule after the leading case on the matter, the highest sales price is matched with the lowest purchase price in any given six month period. *Id.* at 530-31. In analyzing the legislative ***1239** history of the statute, the court in *Smolowe* concluded:

The statute is broadly remedial. Recovery runs not to the shareholder, but to the corporation. We must

suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty. The only rule whereby all possible profits can be surely recovered is that of lowest price in, highest price out within six months.

Smolowe v. Delendo Corp., 136 F.2d 231, 239 (2d Cir.1943), *cert. denied*, 320 U.S. 751, 64 S.Ct. 56, 88 L.Ed. 446 (1943).

[6] Calculating the profit in this case is straightforward. The Jains paid nothing for shares that were transferred, therefore their purchase price is $0. Within six months of acquiring the InfoSpace shares for nothing, the Jains sold shares for $202,551,696.05. Consistent with the definition of profit and the "lowest in, highest out" rule, therefore, the Jains' profit is calculated at $202,551,696.05.

The Jains contend that, even though they acquired the InfoSpace shares for nothing, the Court should nonetheless impute a price to the shares because the Jains ultimately returned the shares to the Trust. A number of cases recognize that a value may be imputed to shares when non-monetary consideration is given. For example, courts will place a dollar value on intangible assets or non-monetary consideration, such as hours worked for a corporation in return for stock. *See, e.g., Truncale v. Blumberg*, 88 F.Supp. 677 (S.D.N.Y.1950). In this matter, however, the Jains gave neither monetary nor intangible consideration for the InfoSpace shares. The shares were

transferred to the Jains for no consideration. As the Court decided on summary judgment and reconsideration, such a transfer-even if it was an unauthorized transfer, with no consideration given, and later rescinded-can be a purchase for the purpose of Section 16(b) because of the possibility for speculative abuse. Because no consideration was given for the InfoSpace shares, the Jains' cost was nothing, and therefore to "squeeze all possible profits out of" the stock transactions requires disgorgement of $202,551,696.05.

Defendants' proposal that the Court should impute the market price of the InfoSpace shares at the time the Jains transferred the shares from the Trusts to themselves, or alternatively at the time the Jains returned the shares to the Trusts, is particularly problematic. This suggestion fails to capture the profit that the Jains realized from the transfers, because the market price of the shares at the time of transfer or return is not related to the profit that an insider might make in transferring shares to a personal account. To illustrate, an insider might transfer a thousand shares valued at $10 each, speculate with those shares to make a profit by buying and selling when the shares are valued at less than $10 each, and then return the shares when they are again valued at $10 each. In such a case, the profit made by the insider through speculation has no relation to the market value of the shares at the time of transfer or return. Such an application of Section 16(b) not only fails to disgorge the profits realized by the transfer, but invites abuse and manipulation of the statute.

[7] The Jains argue that Plaintiff's proposed judg-

ment is unconstitutional and punitive because it forces disgorgement of all profit on the sale of the InfoSpace shares even though the Jains eventually returned an equal number of shares to the Trusts. Because the share transfers were unauthorized, the Jain Defendants contend ***1240** that had they not returned the shares, they might have faced liability to the Trusts for conversion. The Jains insist that, because the transfers were rescinded, disgorgement of all profit would in effect mean the Jains paid twice for the shares at issue.

[8][9][10] The Jains cannot use their conduct in avoiding liability to the Trusts under state or other federal law as a method to avoid Section 16(b) disgorgement. "The determination that an act is illegal under state law and the Internal Revenue Code does not make the rescission of that act free from federal securities law problems.... The exercise of the duty to rescind ... does not immunize the rescinding transaction from securities law liability." *Oliff v. Exchange Int'l Corp.*, 449 F.Supp. 1277, 1293 (N.D.Ill.1978), *aff'd*, 669 F.2d 1162 (7th Cir.1980), *cert. denied sub nom.*, 450 U.S. 915, 101 S.Ct. 1358, 67 L.Ed.2d 340 (1981). The Jains' conduct in transferring shares simply subjected them to multiple legal obligations. "The fact that other state or federal laws may have affected a penalty or caused defendants in a section 16(b) proceeding to take a particular action does not prevent a finding of section 16(b) liability." *Id.* As this Court ruled on summary judgment and on reconsideration, the Jains' transfers of the stocks from the Trusts and subsequent short-swing sales subjected them to liability because of the possibility of speculative abuse. The collateral obligations the Jains acquired regarding the transferred shares, and

the actions they took in response to these obligations, do not impact the calculation of short-swing profits. Therefore, the profit realized by the Jains by short-swing trades is $202,551,696.05. Although courts recognize that Section 16(b) may be harsh in application, Defendants cite no authority for finding the statute unconstitutional. Section 16(b) has been applied for decades, and this Court declines the invitation to strike the statute as unconstitutional.

B. Prejudgment Interest

[11][12] Whether prejudgment interest is awarded as part of a Section 16(b) recovery is a question of fairness to be answered by balancing the equities. *Whittaker,* 639 F.2d at 533. Although prejudgment interest is generally considered a part of Section 16(b) recovery, it is denied when its exaction would be inequitable. *Id.* The burden is on the insider to "show there is an overriding inequity in allowing interest in order to overcome the granting of interest." *Id.*

[13] In weighing the equities, the Court takes into account several factors: (1) whether the insider acted innocently or knowingly; (2) whether the insider repaid the corporation promptly upon demand; and (3) whether there has been substantial delay caused by the insider. *Whittaker* at 533-34.

1. Appropriateness of Prejudgment Interest

[14][15] The Court's consideration of the first factor is not a one-dimensional question of subjective good or bad faith. *Whittaker,* 639 F.2d at 533. The type and degree of the insider's inadvertence, the position

of the insider in the corporation, and other circumstances of each case are considered. *Id.* Even when bad faith may have been absent, interest is still sometimes awarded. *Id.* The insider's good faith must be shown; bare allegations are not sufficient. *Id.*

[16] The Court cannot conclusively determine whether the Jains acted in either good faith or bad faith. However, Mr. Jain's status as a key insider weighs in favor of prejudgment interest. Mr. Jain ***1241** was the founder, Chairman of the Board of Directors, and CEO of InfoSpace. The Jains claim that they were victims of a combination of errors and oversights by others. Nonetheless, without the participation of the Jains, the purchases would not have happened. The Jains transferred shares to their personal accounts by signing letters of authorization and claim to have failed to notice the discrepancies in their account statements. Mr. Jain personally signed SEC filings representing that he had placed shares into escrow. Although the Jains may not have acted in bad faith, they clearly were not diligent in their transactions with the Trusts.

The second factor rewards an insider who repays the corporation promptly upon demand. Prompt payment has been taken as betokening good faith and justifying denial of interest, especially when the prompt repayment means the corporation has not lost use of the money for a long time. *Whittaker,* 639 F.2d at 534.

The second factor favors the Plaintiff. The Jains did not offer to repay the profits upon filing of the lawsuit. Though it is important to note that the corpora-

tion did not decide to bring suit, the corporation nonetheless has been deprived of the use of the money at issue for several years because of the Jains' actions.

The third factor in balancing the equities is the length of time involved. When there has been substantial delay between transactions and complaint or between complaint and judgment, courts consider who was responsible for the delay an important factor in allowing interest for such periods. *Whittaker*, 639 F.2d at 534.

Considerations of delay favor an award of prejudgment interest. Several years have passed since the complaint and this ruling on judgment. The Court ultimately agrees with the liability and judgment arguments that Plaintiff advances in this litigation. While it is understandable that Defendants would litigate this matter, they are nonetheless responsible for the delay between complaint and judgment.

Defendants have failed to meet their burden of showing that an award of prejudgment interest is inequitable. The factors to weigh in deciding to award prejudgment interest favor Plaintiff. Defendants have enjoyed the profits from the short-swing trade for years, and have had the opportunity to invest and earn from these profits. Accordingly, the Court GRANTS Plaintiff's request for prejudgment interest.

2. Calculation of Interest

In awarding prejudgement interest, the Ninth Circuit favors application of the federal post-judgment interest rates specified in 28 U.S.C. § 1961. *Western*

Pacific Fisheries, Inc. v. S.S. President Grant, 730 F.2d 1280, 1289 (9th Cir.1984). The parties do not dispute that interest for transactions completed on April 6 is calculated at 4.732% per year, compounded yearly, and for transactions completed on May 24, 1999 the interest is 4.727%. Neither have the parties disputed that interest should be awarded from the date of the sales which produced the profit that the Jains have since held.

The Jains realized $85,600,000.00 in profit from the April 6, 1999 sale. The Court awards prejudgment interest at a rate of 4.732% per year from the date of the sale to the date of this order. Defendants have not contested that the calculation of this award amounts to $18,297,057.00 plus $13,352.00 for each day after June 13, 2003. Therefore, the Court awards $18,297,057.00 plus $921,288.00 in prejudgment interest, for a total of $19,218,345.00 on the April 6, 1999 sale.

The Jains realized $116,951,696.05 in profit from the April 6 and May 13, 1999 sales and the May 24, 1999 purchase. The ***1242** Court awards prejudgment interest of 4.727% per year on this amount from the date of the purchase to the date of this order. Defendants have not contested that the calculation of this award amounts to $24,095,542.98 plus $18,219.26 for each day after June 13, 2003. Therefore, the Court awards $24,095,542.98 plus $1,257,128.94, for a total of $25,352,671.92 in prejudgment interest on the May 24, 1999 purchase.

C. Total Judgment

The Court orders disgorgement of $202,551,696.05 in

profit. Prejudgment interest on this sum amounts to $44,571,016.92. Total judgment is for $247,122,712.97.

III. Separate Judgment Under Rule 54(b)

Plaintiff requests that the Court enter separate judgment on the claims against the Jain Defendants in accordance with Fed.R.Civ.P. 54(b). "[T]he Court may direct the entry of a final judgment as to one or more but fewer than all of the claims or parties only upon an express determination that there is no just reason for delay and upon an express direction for the entry of judgment." Fed.R.Civ.P. 54(b). The only Defendants remaining after resolving this motion are the Trusts. Withholding judgment until the claims of the Trusts are resolved only serves to delay any appeal of the claims of the Jain Defendants, who have already indicated through a motion for interlocutory appeal that they wish to appeal this Court's decision. There being no just reason to delay entry of judgment, the Court will enter separate judgment on the claims against the Jain Defendants.

CONCLUSION

The Jain Defendants engaged in short-swing trades by transferring for no consideration millions of InfoSpace shares from Trust accounts to personal accounts within six months of selling InfoSpace shares. Under Section 16(b) the Jain Defendants are required to disgorge the profit from these trades. Accordingly, Plaintiff's motion for entry of judgment is GRANTED and the Jain Defendants' motion for partial summary judgment is DENIED. The Court orders disgorgement of $202,551,696.05 of profit from

short-swing trades. Prejudgment interest on this sum amounts to $44,571,016.92, for a total judgment of $247,122,712.97. The Court authorizes publication of notice of Plaintiff counsel's forthcoming request for fees in The Wall Street Journal and The Seattle Times.

W.D.Wash.,2003.
Dreiling ex rel. Infospace, Inc. v. Jain
281 F.Supp.2d 1234

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United States District Court, W.D. Washington.
Thomas R. DREILING, on behalf of INFOSPACE, INC., Plaintiff,
v.
Stiles A. KELLETT, Jr., an individual; and Kellett Partners LP, a limited partnership, and Naveen **Jain** and Anuradha **Jain**, husband and wife, and their marital community, the **Jain** Family Irrevocable Trust, the Naveen **Jain** Grat No. 1 Trust, and the Anuradha **Jain** Grat No. 1 Trust, Defendants,
and
Infospace, Inc., Nominal Defendant.
No. C01-1528P.

May 14, 2003.
Order Denying Reconsideration July 9, 2003.

Shareholder brought suit against settlors of trusts, consisting of corporation's shares, seeking to recover on behalf of corporation short-swing profits allegedly made by settlors based on theory that they purchased securities when they moved them from trust to an escrow and into individual trading accounts. Parties moved and cross moved for summary judgment. The District Court, Pechman, J., held that: (1) settlors were not beneficial owners, for purposes of claims that transactions were changes in beneficial ownership not subject to short-swing profits; (2) movement of shares from trust to escrow counted as purchase for short-swing profit purposes; (3) no gifts were involved; and (4) there was valid escrow, precluding claim of no liability because of no escrow.

Judgment for shareholder.

*1216 William H. Beaver, Jr.,Karr Tuttle Campbell, Seattle, WA, for Naveen Jain Grat No 1 Trust, Defendant.

Beth Ann Colgan, Harry H. Schneider, Jr., Brent Snyder, Perkins Coie, Seattle, WA, for Jain Family Irrevocable Trust, Defendant

Timothy P Crudo, Paul H Dawes, David M. Friedman, Latham & Watkins, San Francisco, CA, Mark Maynes, Stokes Lawrence, Seattle, WA, Kevin Michael Paulich, Wolfstone, Panchot & Block, Seattle, WA, John C Tang, Aaron Levine & Associates, Washington, DC, for InfoSpace Inc, Interested Party.

Judith A Endejan, Graham & Dunn, Seattle, WA, Elaine L Spencer, Graham & Dunn, Seattle, WA, for Seattle Times Company, Intervenor.

Christine E Gardiner, Karr Tuttle Campbell, Seattle, WA, for Anuradha Jain Grat No 1 Trust Defendant.

Douglas W Greene, Barry M. Kaplan, Perkins Coie, Seattle, WA, for Kellett Partners LP, Stiles A Kellett, Jr, Defendants.

Arthur W. Harrigan, Jr., Danielson Harrigan & Tollefson, Seattle, WA, G. Val Tollefson, Danielson Harrigan & Tollefson, Seattle, WA, for Anuradha Jain, Defendant.

Jonathan P Meier, Stephen John Sirianni, Richard E. Spoonemore, Sirianni & Youtz, Seattle, WA, for Thomas R Dreiling, Plaintiff.

ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

PECHMAN, District Judge.

This matter comes before the Court on cross-motions for summary judgment. (Dkt.Nos.68, 82.) Plaintiff

alleges that the Jain Defendants engaged in prohibited short-swing trades of InfoSpace stock by *1217 transferring shares from the Defendant trusts to personal and escrow accounts. Because these transfers are purchases for purposes of determining short-swing trades, Plaintiff's motion for summary judgment is GRANTED and Defendants' motion for summary judgment is DENIED.

BACKGROUND

This is a suit by a shareholder of InfoSpace, Mr. Dreiling, against numerous insider Defendants, alleging that the insiders engaged in unlawful short swing trading-the purchase and sale (or vice versa) of stock within a six month period. There are two groups of Defendants in this matter: the Jain Defendants and the Kellett Defendants. The Kellett Defendants have settled the claims against them. (Dkt. No. 133.) Currently before the Court are cross-motions for summary judgment on Plaintiff's claims against the Jain Defendants. The Jain Defendants are the Naveen Jain, a founder and former CEO of InfoSpace, Anuradha Jain, and three trusts established by the Jains for the benefit of their children.

This litigation arises from stock transfers from three trusts established by the Jains in mid-1998: the Naveen Jain Grantor Retained Annuity Trust No. 1 ("NJGRAT"), the Anuradha Jain GRAT ("AJGRAT"), and the Jain Family Irrevocable Trust ("Family Trust"). The Jains established these trusts for tax purposes. Each of the two GRATs were initially funded with two million shares of InfoSpace stock. The Family Trust purchased one million shares of InfoSpace stock from the Jains. Naveen Jain's broth-

er, Atul Jain, was named as the trustee of both GRATs. The GRATs are irrevocable, and the Jains receive annual annuities from the GRATs. Under the terms of the GRATs, the trustee is the owner of the trust estate The remainder of the trust estate of the GRATs is paid out to the Jains' children after the Jains' death. Unlike the GRAT, the Family Trust pays no annuity and the sole beneficiaries are the Jains' children.

Plaintiff alleges that the Jain Defendants engaged in four purchases that subject them to liability for short-swing trades. The first purchase allegedly occurred in December 1998, when Mr. Jain took one million InfoSpace shares from a trust and placed this stock in escrow to satisfy a personal indemnity obligation. The second, third, and fourth purchases took place in May 1999, when the Jains deposited trust shares into their personal trading accounts. Defendants argue that the above transactions were not "purchases," as they are understood under securities law.

The first alleged purchase in December 1998 occurred when Mr. Jain agreed to place in escrow one million shares of his InfoSpace stock. As InfoSpace was preparing for its initial public offering ("IPO") in late 1998, the Board of Directors learned that Mr. Jain might have incurred liability on behalf of InfoSpace through option grants and disputes arising out of commercial contracts. InfoSpace hired the law firm PerkinsCoie to investigate, and the Board later required Mr. Jain to personally indemnify the company for potential claims by placing one million shares of his InfoSpace stock in escrow. Mr. Jain executed an agreement with InfoSpace to establish an

escrow, with InfoSpace as the escrow agent. PerkinsCoie drafted a Securities and Exchange Commission ("SEC") amendment filed on behalf of InfoSpace. (Spoonemore Decl. Ex. 24.) This filing represented that Mr. Jain had placed one million shares of common stock held by the NJGRAT trust in escrow, and that Mr. Jain retained voting control over those shares. (*Id.* Ex. 25.) Because the NJGRAT trust is irrevocable, Mr. Jain had no authority to transfer these shares.

*1218 Over the next year, Mr. Jain signed, or authorized his attorney in fact to sign, numerous SEC filings representing that he had placed the NJGRAT shares in escrow. (*Id.* Exs. 25-34.) A year later, after no claims were made against InfoSpace for Mr. Jain's actions, Mr. Jain requested that the Board release the escrowed shares. In early 2000, the Board officially released Mr. Jain from the indemnity agreement and the shares from escrow. Plaintiff alleges that the escrow agreement was an unlawful transfer of shares to Mr. Jain from the NJGRAT, triggering liability for short swing trades. Defendants contend that no escrow was ever in fact created. Despite the SEC filings, Mr. Jain states that neither he nor InfoSpace officially established the escrow. Defendants' attorneys in this matter, PerkinsCoie, states that it "is not clear why those [reporting] mistakes [to the SEC] were made." (Def's Resp. at 6.) Defendants produce statements from numerous other witnesses testifying to their lack of knowledge of an escrow account.

The other alleged purchases in May 1999 occurred when the Jains deposited shares of the trusts into their personal brokerage accounts. In May 1999, In-

foSpace stock split two-for-one. InfoSpace then issued new stock certificates representing the new shares and sent these certificates to its shareholders. The NJGRAT and AJGRAT split share certificates were sent to InfoSpace's office, while the Family Trust split share certificate was sent to the Jains' home. These stock certificates were marked on their face as belonging to the trusts. Although the trust accounts were held by Banc of America Securities, the Jains sent the shares to their personal broker at Hambrecht & Quist ("H & Q").[1] H & Q deposited the Family Trust shares in the Jains' personal account. H & Q then sent the Jains a draft letter of authorization that would "gift" the GRAT split shares to the Jains. After the Jains filled out these forms and returned them to H & Q, the shares were deposited into the personal trading accounts of the Jains. The Jains held and controlled these shares, for example by voting on them, until 2000, when it is alleged this "transfer error" was discovered. The Family Trust shares were reconveyed to the trust in May 2000. An InfoSpace paralegal who was responsible for tracking shares noticed a discrepancy in the Jains' account. (Haberly Dep. at 14-15.) However, Mr. Jain states that he initiated the request that InfoSpace undertake an internal investigation to determine what stock was held in each account, thereby identifying the transfer error. As a result of the investigation, the split shares were transferred back to the GRATs in December 2000.

The Jains claim that the transfers were innocent

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[1] The record is confused regarding whether Nationsbanc or Banc of America was the holder at the time.

mistaken deposits. Mr. Jain states that he mistakenly believed that the Jain Trusts maintained accounts at H & Q. The Jains declare that they did not know that signing the letters of authorization would effect a gift of shares from the GRATs to their personal trading accounts. Because they did not read their brokerage statements, the Jains claim they were not aware of the transfers.

ANALYSIS

The parties stipulated to presenting the issues in this case before the Court on cross-motions for summary judgment. (Dkt. No. 50.)Summary judgment is not warranted if a material issue of fact exists for trial. ***1219** *Warren v. City of Carlsbad,* 58 F.3d 439, 441 (9th Cir.1995), *cert. denied,* 516 U.S. 1171, 116 S.Ct. 1261, 134 L.Ed.2d 209 (1996). The underlying facts are viewed in the light most favorable to the party opposing the motion. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). "Summary judgment will not lie if ... the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). The party moving for summary judgment has the burden to show initially the absence of a genuine issue concerning any material fact. *Adickes v. S.H. Kress & Co.,* 398 U.S. 144, 159, 90 S.Ct. 1598, 26 L.Ed.2d 142 (1970). However, once the moving party has met its initial burden, the burden shifts to the nonmoving party to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. *Celotex Corp. v. Catrett,* 477 U.S. 317, 323-24, 106 S.Ct. 2548, 91

L.Ed.2d 265 (1986). To discharge this burden, the nonmoving party cannot rely on its pleadings, but instead must have evidence showing that there is a genuine issue for trial. *Id.* at 324, 106 S.Ct. 2548.

Section 16(b) of the 1934 Securities and Exchange Act contains a blanket prohibition on insiders engaging in short-swing trades-purchasing and selling (or vice versa) within a six-month window. 15 U.S.C. § 78p(b). This is a bright-line rule designed to combat the possibility of unfair insider trading. An insider may be a corporate officer, director or 10% shareholder. *Id.* at (a)(1). If any corporate insider engages in short-swing trades, a shareholder may bring suit on behalf of the company, forcing the insider to disgorge all profits to the company. *Id.* at (b). The principal issue raised in the cross-motions for summary judgment is the legal question of whether the trust transactions are purchases under federal securities law. Defendants make three basic arguments: (1) because the transfers from trusts to personal or escrow accounts did not constitute a change of beneficial ownership of the InfoSpace shares, none of the four disputed transactions was a purchase; (2) while the transfers from the trust to personal and escrow accounts may be mistakes or gifts, they are not purchases; (3) since no escrow was ever in fact established, Mr. Jain never purchased the InfoSpace that were to be placed in escrow.

[1] It should be noted that Defendants' protests of innocent intentions are largely irrelevant since Section 16(b) imposes strict liability for short-swing trades. The statute requires disgorgement to the company of any profit derived from the matching of any purchase and any sale of an "equity security"

within a six-month period by a statutory insider, irrespective of intent. *Gwozdzinsky v. Zell/Chilmark Fund, L.P.*, 156 F.3d 305, 308 (2d Cir.1998). "No showing of actual misuse of inside information or of unlawful intent is necessary to compel disgorgement." *Magma Power Co. v. Dow Chem. Co.*, 136 F.3d 316, 320 (2d Cir.1998). Rather, Section 16(b) "operates mechanically, and makes no moral distinctions, penalizing technical violators of pure heart, and bypassing corrupt insiders who skirt the letter of the prohibition." *Id.* at 320-21. The statute, therefore, "imposes liability without fault ... within its narrowly drawn limits." *Id.* at 321.

I. Change in Beneficial Ownership

[2] Section 16 liability for short-swing trades does not attach if the owner of a stock merely changes his or her form of ownership. Such a transaction is not a purchase, but a mere change in beneficial ownership. Changes in beneficial ownership are exempted from Section 16(b) liability.***1220** 17 C.F.R. § 240.16a-13. Defendants argue that all four transfers from the trusts to personal and escrow accounts were mere changes in the form of beneficial ownership. Plaintiff argues that the Jain Defendants did not have beneficial ownership of the stock in any of the trusts.

The general definition of "beneficial owner" is broad, and Defendants urge the Court to interpret the definition to include persons such as the Jains who receive annuities from a trust:

[T]he term beneficial owner shall mean any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or other-

wise, has or shares a direct or indirect pecuniary interest in the equity securities, subject to the following.

(i) The term pecuniary interest in any class of equity securities shall mean the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities.

Rule 16a-1(a)(2). However, the regulations refer to another section to determine how to analyze beneficial ownership in the specific context of trusts.
(ii) The term indirect pecuniary interest in any class of equity securities shall include, but not be limited to:

. . . . .

(E) A person's interest in securities held by a trust, *as specified in § 240.16a-8(b).*

Rule 16a-1(a)(2) (emphasis added). Rule 16a-8 spells out how to analyze trust ownership.

The "settlor" or founder of the trust is considered the beneficial owner "where they have the power to revoke the trust without the consent of another person." Rule 16a-8(a)(2)(ii). There is no dispute that the Jains did not have the power to revoke the trusts, therefore the fact that they are settlors does not make them beneficial owners.

The beneficiary of the trust is considered a beneficial owner in a number of circumstances:

(3) Beneficiaries. A beneficiary subject to section 16

of the Act shall have or share reporting obligations with respect to transactions in the issuer's securities held by the trust, if the beneficiary is a beneficial owner of the securities pursuant to § 240.16a-1(a)(2), as follows:

(i) If a beneficiary *shares investment control* with the trustee with respect to a trust transaction, the transaction shall be attributed to and reported by both the beneficiary and the trust;

(ii) If a beneficiary *has investment control* with respect to a trust transaction without consultation with the trustee, the transaction shall be attributed to and reported by the beneficiary only;

Rule 16a-8(b) (emphasis added). The Jains do not fall under either of the above categories. Although the Jains received annuity payments, they did not control the trust or share investment control with the trustee. Therefore, the Jains were not beneficial owners of the trust.

Treatises and case law agree that the above analysis directs the determination of beneficial ownership of trusts for purposes of Section 16 liability. *See Feder v. Frost,* 220 F.3d 29 (2d Cir.2000); Bloomenthal & Wolff, 3D *Securities and Federal Corporate Law* § 21.26 at 21-40 (2d ed 2002) ("Beneficiaries of a trust generally will not have the requisite voting or investment control to be beneficial owners for the purpose of determining insider status."), Loss & Seligman, V *Securities Regulation* at 2425 n. 169 (3d ed.2001). For example, a beneficiary has been held liable under Section 16 when he "purchased" shares with an IOU from a trust of which he was a benefi-

ciary. *1221*Morales v. Quintiles Transnational Corp.*, 25 F.Supp.2d 369 (S.D.N.Y.1998). A transfer of InfoSpace shares from the trust to the Jains' personal accounts is a change in beneficial ownership

The public policy underlying the reporting and beneficiary ownership rules on trusts further bolsters Plaintiff's position. If the Jains did not control investment decisions of the trust, or even have reason to know of the transactions the trustee made, then it would be unfair to count such transactions as purchases or sales of the Jains. On the other hand, if the Jains maintained control over the investment decisions of the trusts and benefitted from those transactions, then the trusts' purchases and sales should be counted as the Jains. Loss & Seligman, V *Securities Regulation* at 2425-26 ("Where investment control is shared, including consultation between the trustee and beneficiary, both the trust and the beneficiary must report the transaction and are responsible for any resulting short-swing profits") (citing Sec. Ex. Act. Rel. 28,869 (1991)). Here, because the Jains did not exercise investment control over the trusts, they are not beneficial owners of the shares of the trusts. Normally, this policy operates to protect non-controlling trust beneficiaries from short-swing liability for trust transactions. In this case, however, the transactions at issue were not solely within the corpus of the trusts, but rather a transfer from the trusts to the Jains. Therefore, the Jains' transfer of shares from the NJGRAT, AJGRAT, and Family Trust to their personal trading accounts constituted a change in beneficial ownership. Also, transfer of stock from the NJGRAT trust to an escrow account to satisfy a personal obligation of Mr. Jain effected a change in beneficial ownership.

The above analysis disposes of two additional issues raised by the Defendants. Because the Jain Defendants admit that they did not report the "misdeposits" from the trusts to their personal accounts that effected a change in beneficial ownership, the statute of limitations is tolled. *Whittaker v. Whittaker*, 639 F.2d 516, 528 (9th Cir.1981), *cert denied*, 454 U.S. 1031, 102 S.Ct. 566, 70 L.Ed.2d 473 (1981); (Def.'s Resp. at 13). While the shares owned by one's spouse or children may be counted as one's own for purposes of being an insider, the above rules on trusts establish that the Jains are not the beneficial owners of the holdings of the trusts.

II. Stock Transfers from the Trusts as Purchases

[3] The term "purchase" is defined in Section 3 of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(13), to include "any contract to buy, purchase, or otherwise acquire." Questions often arise as to whether a particular transaction qualifies as a "purchase" or "sale" within the meaning of the statute. Courts have answered this question by applying essentially two types of analysis. For transactions which are ordinary (e.g. cash for stock) "purchases" or "sales," generally referred to as "orthodox" transactions, Section 16(b) has been strictly applied, using an "objective" analysis. *See Whittaker*, 639 F.2d at 522. Therefore, in an "orthodox" transaction, Plaintiff need not show any possibility for speculative abuse-it is presumed. For transactions which are not ordinary "purchases" or "sales," generally termed "unorthodox" or "borderline" transactions, courts have developed a "pragmatic" or "subjective" analysis to test whether the transaction is of the type that Congress sought to prohibit. *Id.* Plaintiff argues

that all four stock transfers from the trusts to personal or escrow accounts are "purchases" under both the orthodox and unorthodox analysis. Defendants contend that the 1999 stock transfers from the trusts to the Jains' personal accounts were *1222 not purchases because there was no possibility of speculative abuse. Even if an escrow was created, Defendants contend that transfer of shares from the NJGRAT trust to the escrow also created no possibility of speculative abuse, and therefore is not a purchase.

A. Choosing the Analysis

There is no clear rule that the Court may apply in this case to determine whether to apply the orthodox or unorthodox test. *See Prager v. Sylvestri,* 449 F.Supp. 425, 430 n. 6 (S.D.N.Y.1978) ("The distinction between borderline or unorthodox transactions and garden-variety [or orthodox] ones is not overly bright."). It is clear to the Court, however, that the alleged purchases here are distinct from the archetypical case of stock-for-cash trades and appropriately categorized as borderline.

First, there was no obvious "purchase" in the sense of an exchange of stock for consideration. This lack of consideration may or may not be fatal to the argument that there was a purchase. As one commentator has noted.

[C]ertain transactions involving no consideration are not a purchase or a sale under Section 16(b): Gifts, stock splits, stock dividends, and receipt of rights distributed to all stockholders pursuant to preemptive rights. Notwithstanding these Section 16(b) cas-

es, transferring a security without receiving consideration could be a Section 16(b) purchase and sale under the proper circumstances. Whether or not a transfer for no consideration is a purchase and a sale, transfers for worthless consideration or inadequate consideration can be Section 16(b) purchases and sales.

Jacobs, *Disclosure & Remedies Under the Securities Laws* § 4:157 (2002). The fact that a transfer with no consideration may or may not be a violation of Section 16(b) raises the considerations of the "unorthodox" analysis. Also, the Ninth Circuit has treated an "overissue" of stock-stock transferred in error-under the unorthodox analysis. *Kay v. Scientex Corp.*, 719 F.2d 1009, 1011-12 (9th Cir.1983). This is the closest case that the parties cite to the transaction at issue here, and the Court considers an erroneous overissue to be similar to the alleged erroneous transfers. Because not every allegedly erroneous transfer could be considered to be an orthodox transaction, it is appropriate to analyze the transactions at issue in this matter under the unorthodox rule.

B. Unorthodox analysis

[4] The Supreme Court has taught that the focus of the unorthodox test should be whether the transaction at issue threatens speculative abuse:

Where alternative constructions of the terms of Section 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders. Thus, in interpreting the terms 'purchase' and 'sale,' courts have properly asked whether

the particular type of transaction involved is one that gives rise to speculative abuse.

Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 593, 93 S.Ct. 1736, 36 L.Ed.2d 503 (1973). In considering whether the type of transaction at issue gives rise to the potential for speculative abuse, two factors are of primary importance: (1) access to inside information; and (2) the ability to influence the timing of a transaction. *Morales v. Gould Investors Trust*, 445 F.Supp. 1144, 1153 (S.D.N.Y.1977), *aff'd*, 578 F.2d 1369 (2d Cir.1978).

Applying *Kern*, the Ninth Circuit has also emphasized that "involuntariness" is an important factor in determining whether***1223** or not a transaction constitutes a "sale" or "purchase" under Section 16(b). *Colan v. Mesa Petroleum Co.*, 951 F.2d 1512, 1522 (9th Cir.1991). The Supreme Court in *Kern* noted not just the lack of a possibility of speculative abuse, but also that the defendant-a company undergoing a merger-had no control over the stock transactions. The Ninth Circuit has effectively made involuntariness into a second requirement for passing the unorthodox test. "Absent a showing of involuntariness, we would not be justified in applying the Kern County rule." *Id.* The Ninth Circuit in *Kay* recited very strong language on voluntariness.

In determining whether the overissuance of shares is a purchase within the meaning of section 16(b) we find it appropriate to inquire into the voluntary nature of the transaction. If an overissuance of stock is done *entirely without participation* by the recipient of the stock it is doubtful the transaction presents the opportunity for speculative abuse condemned by

section 16(b). If, however, the recipient is *instrumental in the overissuance,* the opportunity for speculative abuse is present.

719 F.2d 1009, 1013 (emphasis added). Other courts have also applied extremely narrow definitions of voluntariness: "Case law establishes a stiff test of voluntariness. So long as the seller retains *any degree of control* over a transaction, its actions will not be found to be involuntary." *Sprague Elec. Co. v. Mostek Corp.,* 488 F.Supp. 842, 845 (N.D.Tex.1980) (emphasis added). Accordingly, the Court evaluates whether the Jains' transactions were neither voluntary nor likely to lead to speculative abuse.

1. Voluntariness

The Jain Defendants' actions were voluntary. The Jains signed papers allowing transfer of funds from the GRATs. The Jains caused deposits of trust stock into their personal brokerage accounts by forwarding stock certificates to their personal broker. Mr. Jain promised to place shares of the NJGRAT trust into escrow to fulfill a personal obligation. The fact that the Jains failed to read their brokerage statements, simply signed legal documents without knowing what they were, and mistakenly sent certificates to their personal broker does not make their actions involuntary. As noted above, their subjective intention is not relevant to a Rule 16(b) analysis. The Jain Defendants are correct that their actions are "less voluntary" than those in the *Kay* overissue case. *See* 719 F.2d at 1013. Nonetheless, the Jains participated in the transfers and retained more than a degree of control over the transactions. Without the participation of the Jains, the transfers would not

have happened. While the Jains' actions in effecting the transfers may not have been culpable, they were voluntary.

2. Possibility of Speculative Abuse

The Jains' transfer of shares to their personal accounts created the possibility of speculative abuse. The Jains had insider knowledge and influence over the timing of the transfers. Again, it does not matter what the Jains intended or what speculative actions they actually took. Rather, it is clear that the transfer of literally millions of shares to a personal account created the possibility of speculative abuse. The Jains could have sold the shares at a high price, repurchased the shares at a lower price, and then transferred the shares back to the trusts. The transfers created the possibility of selling, or "freeing up" for sale, the Jains' personal shares. The *Kay* court found as a matter of law that acquisition through an erroneous overissuance and consequent sale for cash demonstrated the possibility of speculative abuse: "When insiders participate in voluntary acquisitions of stock coupled with conventional sales, the possibility of speculative***1224** abuse of insider information is present. Neither proof of actual abuse of insider information nor proof of intent to profit on the basis of such information is necessary under section 16(b)." 719 F.2d at 1013. Plaintiff demonstrates both voluntariness and the possibility of speculative abuse.

C. Gifting

[5] Defendants argue that the transfers may be characterized as gifts. Bona fide gifts are exempted from

Section 16(b). Rule 16b-5 ("Both the acquisition and the disposition of equity securities shall be exempt from the operation of Section 16(b) of the [Exchange] Act if they are bona fide gifts."). Gifts are not sales or purchases when made in good faith and without subterfuge. *See Shaw v. Dreyfus,* 172 F.2d 140, 142-43 (2d Cir.1949), *cert. denied,* 337 U.S. 907, 69 S.Ct. 1048, 93 L.Ed. 1719 (1949).

There is no evidence that the trusts gifted the shares, or had the authority to gift the shares, to the Jain Defendants. There is no evidence that the Jain Defendants had the power or authority to gift the trust shares to themselves. An allegedly erroneous transfer cannot be reclassified as a gift to escape liability for short-swing trades.

Because the Jains' transfers of stock in 1999 from the NJGRAT, AJGRAT, and Family trust were voluntary and created the possibility of speculative abuse, they constitute purchases for purposes of Section 16(b) liability. Mr. Jain's placement of NJGRAT shares into an escrow account also was voluntary and created the possibility for speculative abuse, and therefore it is a purchase.

III. Existence of the Escrow Account

[6] Defendants insist that the escrow account of the one million InfoSpace shares from the NJGRAT was never in fact established. Plaintiff argues that the SEC filings and actions of the parties demonstrate the existence of the escrow.

On December 11, 1998, Mr. Jain and InfoSpace executed an indemnification agreement to establish

the escrow fund at issue. (Spoonemore Decl. Ex. 23 at 1, 4.) That same day, Mr. Jain was to deliver "to the Escrow Agent certificates representing 1,000,000 shares of the Company's Common Stock ..." (*Id.* at 4.) The agreement appointed InfoSpace as the escrow agent. (*Id.* at 9.) The agreement stated that Mr. Jain was to have the right to vote the escrowed stock and receive cash dividends, while the escrow agent had the right to possess the escrowed stock. (*Id.* at 4.)

The agreement is governed by Washington law. (*Id.* at 10.) In Washington, an escrow is defined as a transaction:

wherein any person or persons, for the purpose of effecting and closing the sale, purchase, exchange, transfer, encumbrance, or lease of real or personal property to another person or persons, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by such third person until the happening of a specified event or the performance of a prescribed condition or conditions, when it is then to be delivered by such third person, in compliance with instructions under which he or she is to act, to a grantee, grantor, promisee, promisor, obligee, obligor, lessee, lessor, bailee, bailor, or any agent or employee thereof.

RCW 18.44.011(4). The escrow agreement between Mr. Jain and InfoSpace reflects the encumbrance and transfer of the personal property of one million shares. The escrow provisions of the agreement did not specify which third person was to hold the stock certificates or where the certificate *1225 would be held. The Court does not find it unusual, however,

that the attorneys for InfoSpace, PerkinsCoie, would hold the certificates. *See FDIC v. Knostman,* 966 F.2d 1133, 1140 (7th Cir.1992). Neither does the failure to identify a third party nor the fact that PerkinsCoie already had possession of the certificates at the time of the agreement's execution prevent formation of the escrow. *See id.* at 1140-41. It is clear that the parties intended and agreed to encumber the personal property and establish an escrow. *Cf.* Stoebuck, 17 *Wash. Prac., Real Estate: Property Law* § 7.11 ("delivery" means "intent." It is possible, and Washington has so held, "for a deed to be delivered though it remains in the grantor's possession, provided his intent that it shall pass title is clearly shown.") The terms of the escrow are not in dispute. Mr. Jain and InfoSpace, with the assistance of PerkinsCoie, represented to the SEC that the NJGRAT shares were placed into escrow. It is undisputed that PerkinsCoie held the certificates when Mr. Jain and InfoSpace signed the agreement. These actions formed an escrow.

Additionally, the Court agrees with Plaintiff that Mr. Jain's pledge of NJGRAT shares created the possibility of speculative abuse. Through the pledge of the NJGRAT shares, Mr. Jain avoided pledging stock he already owned, thereby gaining an opportunity to trade a million shares that otherwise would have been encumbered. Mr. Jain incurred no risk that the one million shares from the NJGRAT would decrease in value, since he did not pay for the shares on their transfer. Because Mr. Jain placed in escrow one million shares of the NJGRAT, he effected a purchase for purposes of liability under Section 16(b).

IV. Motion to Strike Expert Report

Plaintiff moves to strike Defendant's expert report. Defendants' expert report on securities law does not assist the Court in resolving the cross-motions. Accordingly, Plaintiff's motion to strike is DENIED as MOOT.

CONCLUSION

Because the transfers at issue in this matter are purchases for purposes of determining short-swing trades, Plaintiff's motion for summary judgment is GRANTED and Defendants' motion for summary judgment is DENIED.

ORDER DENYING DEFENDANTS' MOTIONS FOR RECONSIDERATION

This matter comes before the Court on Defendants' motions for reconsideration. Defendant Naveen Jain moves for reconsideration of this Court's order on summary judgment, (Dkt. No. 157), as do the Jain Trusts and Anuradha Jain, (Dkt. No. 159). Defendants contend that the Court erred in concluding that Defendants are liable under Section 16(b) for trust transactions because: (1) the trustee can rescind the stock transfers and therefore avoid Section 16(b) liability; and (2) no escrow was created. The Jain Trusts also move for a Rule 56(f) continuance to conduct discovery to support an additional motion for reconsideration, which would be filed after the ten day deadline for reconsideration motions. (Dkt. No. 152.)

Motions for reconsideration are disfavored. Local

Rule CR 7(h)(1). The court will ordinarily deny such motions in the absence of a showing of manifest error in the prior ruling or a showing of new facts or legal authority which could not have been brought to its attention earlier with reasonable diligence. *Id.* The Court disagrees with Defendants' contentions of manifest error, and accordingly Defendants motions for reconsideration are DENIED. Because Defendant has failed to demonstrate grounds for a late Rule 56(f) ***1226** continuance, Defendants' motion is DENIED.

I. Rescission

Defendants argue that the trustee can rescind any transfers from the trusts to the Jains on the grounds that such transfers were invalid because the trustee never approved them. Rescission, Defendants argue, eliminates Section 16(b) liability.

First, this is an inappropriate new argument, and Defendants have failed to show why this issue could not have been raised on the cross-motions for summary judgment. *Rosenfeld v. United States Dep't of Justice,* 57 F.3d 803, 811 (9th Cir.1995). The fact that Defendants hired new counsel after losing on summary judgment is not by itself justification for raising new issues on reconsideration and effectively relitigating the prior order.

Second, the Court does not agree on the existence of a broad rule eliminating invalid, later rescinded transactions from Section 16(b) liability. *See Oliff v. Exchange Int'l Corp.,* 449 F.Supp. 1277, 1291 (N.D.Ill.1978) ("The issue is thus not whether a rescission took place but whether the particular rescis-

sion constituted a purchase within the meaning of section 16(b)."). If Section 16(b) liability could be avoided by rescission, then all potential defendants in such actions could simply rescind in the face of a lawsuit. The mere fact that a transfer is invalid does not insulate a person from Section 16(b) liability. *See Kay v. Scientex Corp.*, 719 F.2d 1009, 1013-14 (9th Cir.1983). The cases that Defendants cite are very narrow exceptions where courts found that rescission demonstrated that there was, in fact, no transaction and no threat of speculative abuse. *See Oliff,* 449 F.Supp. at 1291-93 (analyzing cases on rescission). Here, in contrast, Plaintiff demonstrated the possibility of speculative abuse.

II. Escrow

Defendant Naveen Jain contends that there is at least a fact issue regarding whether or not an escrow exists. In its Order on the cross-motions for summary judgment, the Court considered the evidence presented by Defendant and concluded that it demonstrated the existence of an escrow. Defendant makes two principle arguments on the escrow issue: (1) that Perkins Coie did not agree to be an escrow agent; and (2) that the SEC filings contained contradictory information supporting the inference that no escrow was created.

Having examined the original briefing on the escrow issue, again the Court finds that both arguments Defendant raises on reconsideration to be new, and therefore inappropriately raised. *Rosenfeld,* 57 F.3d at 811. Nonetheless, the Court does not agree with Defendant's contentions. Defendant argues that Perkins Coie had to agree to be an "escrow agent" to

the transaction in order for the escrow to exist, but cites a 1973 District of Columbia Court of Appeals case for the proposition. (Jain Recon. at 2.) Regardless, the terms of the escrow agreement name InfoSpace as the escrow agent. InfoSpace's counsel, Perkins Coie, had possession of the shares and clearly knew of the agreement. The Court found these undisputed facts sufficient for establishing the existence of an escrow.

Defendant also contends that SEC filings are contradictory. In several cases the filings indicate that Mr. Jain "has agreed" to escrow "beneficially owned" shares, whereas in another the filing states that Mr. Jain had established the escrow with trust shares. The Court does not believe that these differences create an issue of fact. The actions of the parties demonstrate the existence of the escrow. Defendant's motion for reconsideration is DENIED.

**1227 III. Rule 56(f) Continuance*

The Jain Trust Defendants seek a Rule 56(f) continuance in order to discover information regarding the formation of an escrow and transfer of trust assets. On obtaining this information, Defendants seek to file an additional motion for reconsideration past the ten day deadline.

A Rule 56(f) motion must be brought before the summary judgment hearing. *United States v. Kitsap Physicians Service,* 314 F.3d 995, 1000 (9th Cir.2002), *citing Ashton-Tate Corp. v. Ross,* 916 F.2d 516, 520 (9th Cir.1990). While other jurisdiction may have recognized exceptions to this rule, Defendants have failed to demonstrate why any exception should

apply here.

Although Defendants contend that the Court made an "unexpected finding" regarding the existence of the escrow, and in particular concerning the actions of Perkins Coie, these issues were argued and briefed by the parties. (*See,* e.g., Pl.'s Mot. Summ. J. at 12) ("Perkins Coie certainly knew that those shares were subject to escrow-it was the very entity that, in drafting the public filings, inserted the statements that the NJGRAT shares had been placed into escrow."). The existence of the escrow was a critical issue on summary judgment, and the Court agreed with the arguments advanced by Plaintiff. Moreover, the parties engaged in significant discovery for nearly a year before submitting cross-motions for summary judgment to the Court. The briefs on the cross-motions for summary judgment were submitted, by stipulation of the parties and order of the Court, past the deadline for dispositive motions. The Court extended the deadline after the parties represented that they expected no trial would be necessary and that the case could be resolved as a matter of law. Defendants' change of attorneys is not grounds for a continuation.

Having failed to show manifest error to the Court, Defendants motions for reconsideration are DENIED. Because Defendant has failed to demonstrate grounds for a late Rule 56(f) continuance, Defendants' motion is DENIED.

W.D.Wash.,2003.
Dreiling ex rel. Infospace, Inc. v. Kellett
281 F.Supp.2d 1215

Supreme Court, U.S.
FILED
FEB 6 - 2009
OFFICE OF THE CLERK

No. 08-838

In The Supreme Court of the United States

NAVEEN JAIN and ANURADHA JAIN,

Petitioners,

v.

J.P. MORGAN SECURITIES INC., WILSON SONSINI GOODRICH & ROSATI, P.C. and PERKINS COIE, LLP,

Respondents.

On Petition For A Writ Of Certiorari To The Court Of Appeals For The State Of Washington

RESPONDENT J.P. MORGAN SECURITIES INC.'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

BINGHAM MCCUTCHEN, LLP
DAVID M. BALABANIAN
Counsel of Record
JOHN D. PERNICK
ROBERT A. BRUNDAGE
NIMA E. SOHI
Three Embarcadero Center
San Francisco, CA 94111
(415) 393-2000

Counsel for Respondent J.P. Morgan Securities Inc.

COCKLE LAW BRIEF PRINTING CO (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTION PRESENTED

Under Section 16(b) of the Securities Exchange Act of 1934, a corporate insider, who both purchases and sells the corporation's stock within a specified period, must disgorge all profits from the transactions. The statute is specifically intended to deprive the insider of such profits.

The question presented is whether Section 16(b) preempts the insider's state-law indemnity claim to regain the forfeited profits.

RULE 29.6 STATEMENT

Pursuant to Supreme Court Rule 29.6, J.P. Morgan Securities Inc. states that it is a wholly-owned subsidiary of JPMorgan Securities Holdings LLC, which is a wholly-owned subsidiary of JPMorgan Chase & Co., a public company. No publicly held company owns 10% or more of JPMorgan Chase's stock.

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OTHER PROVISIONS INVOLVED

In addition to Section 16(b) of the Securities Exchange Act of 1934 (quoted at Petition 2-3), this case involves Article VI, clause 2 of the United States Constitution. It provides that federal law "shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2.

STATEMENT OF THE CASE

This is an indemnity action arising out of an underlying federal-court judgment against Petitioners under Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p). Under Section 16(b), a corporate insider who sells and purchases (or purchases and sells) the company's stock within a six-month period must forfeit to the corporation all profits from the purchase and sale. Such profits are known as "short-swing" profits. Congress specifically enacted this law to deprive insiders of all profit from such transactions, as a blunt but effective method of eliminating the incentive for transactions it deemed especially susceptible to abuse. Pp. 9-11, 18-20 below.

As detailed below, the district court in the underlying case found that Petitioners had engaged in purchases and sales within a six-month period. It compelled Petitioners to disgorge their profits as Section 16(b) required. Petitioners subsequently brought the current indemnity action in Washington

state court, trying to force Respondents to reimburse the profits that Petitioners had disgorged.

I. THE UNDERLYING SECTION 16(b) JUDGMENT AGAINST PETITIONERS; FINDINGS OF UNDISPUTED FACT.

Petitioners are Naveen Jain and his wife Anuradha Jain. Mr. Jain was the founder, Chairman of the Board of Directors, and CEO of a corporation called InfoSpace. In 2001, an InfoSpace shareholder brought a derivative action against Petitioners on behalf of InfoSpace in the United States District Court for the Western District of Washington. The action sought to compel Petitioners to disgorge to InfoSpace Petitioners' profits on short-swing sales of InfoSpace stock, under Section 16(b). No recovery was sought under any other federal securities law.

The Section 16(b) Action against Petitioners concerned two sets of transactions by which Petitioners acquired shares in InfoSpace from trusts that Petitioners had established for tax purposes. *See* Petition ("Pet.") A-62-63. Contrary to the petition's representations, Petitioners were not innocent lambs caught up in these transactions solely as a result of others' actions. These assertions were squarely raised and resolved against Petitioners in the Section 16(b) Action.

The first transaction occurred when InfoSpace demanded that Mr. Jain "personally indemnify the company" for certain claims by "placing one million

shares of his InfoSpace stock in escrow." Pet. A-63. Mr. Jain took one million InfoSpace shares from one of the trusts, and placed them in escrow. Pet. A-63-64. The district court found that this transaction was a purchase under Section 16(b). Pet. A-78.

The petition for certiorari incorrectly represents that "no such escrow was ever established" and advises that it is a "verity" that Petitioners did not know of the transactions that created it. Pet. 4, 6, 9, 16. The district court found precisely the opposite in entering summary judgment against them in the underlying 16(b) case. Pet. A-78-80.

Specifically, the court found that Mr. Jain himself "executed an indemnification agreement to establish the escrow fund." Pet. A-78-79. The court found that there was an "escrow agreement between Mr. Jain and InfoSpace" that "reflects the encumbrance and transfer of the personal property of one million shares," and it "is clear that the parties intended and agreed to encumber the personal property and establish an escrow." Pet. A-79-80. Besides personally signing the escrow agreement, Mr. Jain also "personally signed SEC filings representing that he had placed shares into escrow." Pet. A-55; *accord* Pet. A-64, A-80. Mr. Jain even "requested that the Board release the escrowed shares" once the one-year escrow period was over. Pet. A-64. Having personally signed the escrow agreement, represented to the SEC that the shares were escrowed, and later requested release of the escrowed shares, Mr. Jain obviously knew about the escrow. And the district court unequivocally

found that these acts "formed an escrow" under Washington law. Pet. A-80.

The court's findings also make clear that Mr. Jain personally benefited by escrowing the trust's shares rather than his own. He "avoided pledging stock he already owned, thereby gaining an opportunity to trade a million shares that otherwise would have been encumbered." Pet. A-80. He also "incurred no risk that the one million shares from the [trust] would decrease in value, since he did not pay for the shares . . . ." Pet. A-80.

Based on these facts, the district court found that "Mr. Jain's placement of [trust] shares into an escrow account . . . was voluntary . . . ." Pet. A-78. The district court further found that this "transfer of stock from the [trust] to an escrow account to satisfy a personal obligation of Mr. Jain effected a change in beneficial ownership" and that it "created the possibility of speculative abuse." Pet. A-71, A-77-78. Accordingly, it found, "he [Mr. Jain] effected a purchase for purposes of liability under Section 16(b)." Pet. A-80.

The other transactions at issue in the Section 16(b) Action concerned the transfer of shares from trust accounts to Petitioners' personal account following an InfoSpace stock split (the "split-share transactions"). Pet. A-64-66. As with the escrow transaction, Petitioners' representations that they were unaware of the actions that created the split-share transactions cannot be reconciled with the district court's findings against them in the underlying case. The

district court expressly found that Petitioners voluntarily participated in these transfers and that the transfers would not have happened without Petitioners' participation. Pet. A-76-77, A-80.

Specifically, Petitioners acquired the shares of three trusts. As to two of these trusts, Petitioners *personally signed* a letter of authorization "gift[ing]" the trusts' new shares to themselves personally. Pet. A-65. Petitioners sent this letter to their personal broker, Hambrecht & Quist ("H&Q").[1] Pet. A-65. H&Q accordingly deposited these shares into Petitioners' personal accounts. Pet. A-65. The district court emphasized in awarding prejudgment interest that "[t]he Jains transferred shares to their personal accounts by signing letters of authorization . . . ." Pet. A-55.

The district court also found that Petitioners voluntarily participated in deposit of the third trust's new shares to their personal account. When Petitioners received this third trust's new InfoSpace stock certificates, Petitioners did not send the certificates to Banc of America, where the *trust's* accounts were held. Pet. A-65. Petitioners sent the certificates to their *personal* broker at H&Q. Pet. A-65. H&Q consequently deposited these shares in Petitioners' personal account. Pet. A-65 (emphasis added).

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[1] Hambrecht & Quist is predecessor in interest of Respondent J.P. Morgan Securities Inc.

As with the escrow transaction, the district court expressly found that the "Jain Defendants' actions were voluntary." Pet. A-76. It further found that Petitioners "caused deposits of trust stock into their personal brokerage accounts by forwarding stock certificates to their personal broker," and they "signed papers allowing transfer of funds from [certain trusts]." Pet. A-76. Thus, Petitioners "participated in the transfers and retained more than a degree of control over the transactions. Without the participation of the Jains, the transfers would not have happened." Pet. A-76-77.

Further, the court found, the transfers "created the possibility of speculative abuse." Pet. A-77. For example, Petitioners could have sold the shares at a high price, repurchased at a lower price, pocketed the difference and returned the shares to the trusts. Pet. A-77. Because Petitioners' transfer of trust shares to their personal accounts constituted a change in beneficial ownership, was voluntary, and created the possibility of speculative abuse, the court found they were "purchases for purposes of Section 16(b) liability." Pet. A-78.

Completing the last link in the Section 16(b) inquiry, the district court also found that Petitioners sold InfoSpace shares within six months of these transactions. Pet. A-51, A-6. Because Petitioners had purchased and sold InfoSpace stock within six months, they were required to disgorge their profits under Section 16(b). The district court found that the Petitioners' profit was the difference between the

amount they paid for the shares ($0) and the amount they realized in the sale, over $200 million. Pet. A-51.

The district court accordingly entered judgment against Petitioners and in favor of InfoSpace for just over $200 million, the amount of the profit. Pet. A-58. The court also awarded prejudgment interest, finding that Petitioners had not established that they acted in good faith in connection with the transactions. Pet. A-55-56, A-59. Petitioners appealed. Pet. A-7. While the case was on appeal, they settled and agreed to pay InfoSpace $65 million for the Section 16(b) claim. They subsequently dismissed their appeal. The judgment is final and not subject to any further review.

II. PETITIONERS' INDEMNITY ACTION.

Following entry of judgment against them in the Section 16(b) Action, Petitioners filed this action in Washington state court. Their current operative complaint alleges claims against Respondents J.P. Morgan Securities Inc., as successor in interest to Hambrecht & Quist; Wilson Sonsini Goodrich & Rosati (JP Morgan's counsel); and Perkins Coie, LLP (InfoSpace's counsel). Petitioners' complaint seeks to recover the amounts that Petitioners paid to settle the Section 16(b) Action, litigation costs such as attorneys' fees incurred in the Section 16(b) Action, and supposed consequential damages from having to pay those litigation costs. It does so on various tort theories such as negligence, breach of fiduciary duty,

equitable apportionment, "recovery of non-settlement damages," and equitable indemnity.

After repeated amendments of Petitioners' complaint, the trial court dismissed the complaint against each Respondent without leave to amend. Pet. A-21, A-25, A-29.

The Washington Court of Appeals affirmed. In accord with every reported case to address the issue, it held that an insider compelled to forfeit profits under Section 16(b) may not obtain indemnity. Such indemnity, the court explained, would frustrate federal law by restoring the profits Congress had deliberately taken away. Pet. A-15. The court also held that all of Petitioners' claims against Respondent JP Morgan are either indemnity or de facto indemnity claims and are barred by the policy against indemnity for Section 16(b) claims. Pet. A-15-16.

Last – and independent of preemption – the Washington Court of Appeals held that because Petitioners' own conduct caused the transactions that made them liable under Section 16(b), as a matter of state law they cannot recover attorneys' fees and other litigation expenses from the 16(b) Action. Washington law does not allow a party whose "own conduct caused it to be 'exposed' or 'involved' in litigation" to recover indemnity for fees and costs from that litigation. Pet. A-17. This is called the ABC rule. Pet. A-16-17. Quoting the district court's findings of undisputed fact set forth above, the Court of Appeals held that "[t]he Jains were not blameless in the transactions

giving rise to their liability." Pet. A-17. Accordingly, "[w]e hold that the Jains' own conduct caused them to be involved in the litigation and, therefore, under the ABC rule they may not recover fees or litigation costs." Pet. A-18.

The Washington Supreme Court denied Petitioners' petition for discretionary review. Pet. A-2. Petitioners then filed their petition for certiorari.

REASONS FOR DENYING THE PETITION

I. ALL LOWER COURTS AGREE THAT SECTION 16(b) PREEMPTS INDEMNITY CLAIMS LIKE PETITIONERS'.

As this Court explained in *Reliance Electric Company v. Emerson Electric Company*, 404 U.S. 418, 422, 92 S. Ct. 596, 30 L. Ed. 2d 575 (1972), Congress enacted Section 16(b) "to curb the evils of insider trading [by] . . . taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." Thus, Congress deliberately deprived short-swing traders of profits under Section 16(b). Allowing them to obtain indemnity under state law would restore those profits to them, frustrating Section 16(b)'s purpose.

Accordingly, the only two appellate decisions on the issue – the decision below and *First Golden Bancorporation v. Weiszmann*, 942 F.2d 726, 729 (10th Cir. 1991) – both hold that Section 16(b) preempts state-law indemnity claims to recover the

profits disgorged under Section 16(b). Petitioners concede that "[t]he Tenth Circuit is the only Court of Appeals that has addressed the indemnification issue in the context of liability imposed by 16(b)." Pet. 24 (citing *First Golden*). That Tenth Circuit decision unambiguously holds such claims preempted: "[W]e hold that the public policy behind section 16(b) renders invalid any attempt by an insider to seek indemnification for his liability under section 16(b)." *First Golden,* 942 F.2d at 729.

Decisions of federal district courts and state lower courts – if relevant at all, *see* Supreme Court Rule 10(a)-(b) – tell the same story. Every court that has addressed the issue has held that state-law indemnity claims, to recover the profits taken away by Section 16(b), are preempted:

- "[T]he Court is persuaded that allowing indemnification for § 16(b) violations would frustrate the public policy behind the statute because liable parties would not have to return their short-swing profits to the plaintiff issuer." *Schaffer v. CC Investments, LDC*, 286 F. Supp. 2d 279, 283 n.6 (S.D.N.Y. 2003).

- "[If] indemnification is found to be valid, then the defendants would have been able to waive, in effect, the requirement of section 16(b). . . . This result would frustrate the public policy behind the prohibition of insider trading within the six-month time period found in section

16(b)." *Bunker Ramo-Eltra Corp. v. Fairchild Indus., Inc.*, 639 F. Supp. 409, 419 (D. Md. 1986).

- "[I]ndemnity for section 16(b) violations would undermine the deterrent purpose of section 16(b) by allowing a wrongdoer to recoup its disgorged profits." *Deephaven Capital Mgmt., LLC v. Schnell*, No. 06-844 (JRT/FLN), 2007 WL 101821, at *3 (D. Minn. Jan. 8, 2007).[2]

Thus, there is nothing to review. All courts to reach the issue agree that indemnity for Section 16(b) liability would frustrate Congress' purpose and is preempted. The scarcity of cases addressing the issue also confirms that it is not of widespread interest.

With no basis to review the issue actually raised by this case, Petitioners try to manufacture a conflict over whether indemnity is consistent with "federal securities laws" generally when "the securities statute" is supposedly satisfied. Pet. i. That question is not even raised by this case. Section 16(b), whose specific objective is to deprive short-swing traders of profits, *see Reliance*, 404 U.S. at 422, would by definition not be "satisfied" if those profits were restored.

But putting that aside, there is no conflict as to whether federal securities laws preempt state-law indemnity claims, even outside the Section 16(b)

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[2] No state appellate court has addressed the issue, besides the courts below.

setting. Not a single federal court of appeals or state court of last resort, including those cited by Petitioners, has allowed a violator of any federal securities law to pursue an indemnity claim. If anything, Petitioners' cases underscore the correctness of the decision below.

For example, *Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969), held that it "would be against the public policy" of the Securities Act of 1933 to allow indemnity. The court reasoned, among other things, that civil liability under that Act was designed to "deter negligence by providing a penalty," and that the "'*in terrorem* effect' of civil liability . . . might well be thwarted if underwriters were free to pass their liability on . . . ." 418 F.2d at 1288. Thus, *Globus* arises under a different securities law, and if on point at all, it agrees, not conflicts, with the decision here. Petitioners vainly try to gin up a conflict by pointing to *Globus*'s statement that it considered only the facts before it, involving conduct graver than ordinary negligence. Pet. 19. But stating that the court is only considering the facts before it does not remotely establish a contrary rule for different facts not before the court. It certainly does not create a conflict with other cases on those supposedly different facts.

Petitioners' other court of appeals cases similarly agree with the result here. All of Petitioners' court of appeals cases addressing state-law indemnity claims hold them *preempted*. *See Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1105 (4th Cir. 1989)

(holding that the federal policy against indemnification for securities violations preempted state law indemnity claim); *Heizer Corp. v. Ross*, 601 F.2d 330, 334 (7th Cir. 1979) (holding that indemnification is preempted because it would "frustrate and defeat" the policy of securities legislation); *Laventhol, Krekstein, Horwath & Horwath v. Horwitch*, 637 F.2d 672, 676 (9th Cir. 1980) (affirming dismissal of an indemnity claim because it would "undermine the statutory purpose" of the securities laws); *Eichenholtz v. Brennan,* 52 F.3d 478, 484 (3d Cir. 1995) (holding that indemnification claims "run counter" to securities law policies and are barred, even if party seeking indemnification was "merely negligent, played a 'de minimis' role . . . or was being held derivatively or vicariously liable").[3] Petitioners' other two cases do not even involve state-law claims for indemnity, and they *deny* any right to indemnification under federal law. *In re U.S. Oil & Gas Litig.*, 967 F.2d 489, 495

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[3] Petitioners note that *Eichenholtz* stated that one defendant, First Jersey, would be able to recover from its agent, Brennan, if First Jersey were held vicariously liable. 52 F.3d at 485 n.13; *see* Pet. 28-29. That has nothing to do with this case. As Petitioners recognize, the district court there, as part of a settlement, had barred claims only against *settling* defendants. Pet. 27-28. Claims against Brennan were not barred "because Brennan is a *non*-settling defendant." 52 F.3d at 485 n.13 (emphasis added). *Eichenholtz* did not allow a party held vicariously liable to obtain indemnity. To the contrary, it expressly held that state-law indemnity claims are preempted even if the party seeking indemnity was "being held derivatively or vicariously liable." 52 F.3d at 484.

(11th Cir. 1992); *King v. Gibbs,* 876 F.2d 1275, 1276 (7th Cir. 1989). None of these cases allows a violator of Section 16(b) or any other federal securities law to obtain indemnity.[4]

Apparently recognizing that their asserted court of appeals conflict is illusory, Petitioners cite district court cases. An asserted conflict with district courts, however, does not warrant this Court's review. *See* Supreme Court Rule 10(a)-(b). In any event, Petitioners' district court cases are off point.[5]

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[4] *Baker, Watts, Heizer* and *Eichenholtz* allow contribution claims in some circumstances. Petitioners here cannot state a contribution claim, as they acknowledge. Pet. 37. Contribution lies only against joint tort-feasors. *All-Pure Chemical Co. v. White,* 127 Wn.2d 1, 4, 896 P.2d 697 (1995) (Washington law "provides for the right of contribution only among 'two or more persons who are jointly and severally liable' ") (quoting RCW 4.22.040(1)). Respondents cannot be joint tort-feasors because Respondents, who did not purchase or sell InfoSpace stock, could not have violated Section 16(b). Pet. 37.

[5] None of Petitioners' district court cases presents a fact situation similar to this case. Petitioners' cases involved (1) a plaintiff seeking indemnity who did not have a judgment entered against it and thus would have an opportunity to prove it was completely without fault, *see Fromer v. Yogel,* 50 F. Supp. 2d 227 (S.D.N.Y. 1999); *Greenwald v. American Medcare Corp.,* 666 F. Supp. 489 (S.D.N.Y. 1987); (2) indemnity *voluntarily* agreed to, *see Raychem Corp. v. Fed. Ins. Co.,* 853 F. Supp. 1170 (N.D. Cal. 1994) and *Cambridge Fund, Inc. v. Abella,* 501 F. Supp. 598 (S.D.N.Y. 1980) (consent order); (3) contribution-type claims against a party who, unlike Respondents here, allegedly violated the securities laws, *see Arden Way Associates v. Boesky,* 664 F. Supp. 863 (S.D.N.Y. 1987); or (4) state-law claims seeking more than plaintiffs' settlement payments and

(Continued on following page)

Petitioners protest that the established no-indemnity rule is unjust, and that they should not be made to lose their profits under Section 16(b) solely through the actions of others. *See* Pet. 15-17. They are far off base, and this case would be a poor vehicle to test any such contention. As detailed above, the district court found that Petitioners personally executed the agreement that created the escrow, personally signed SEC filings stating that the shares had been placed in escrow, personally signed letters "gifting" trust shares to their personal accounts, and personally sent trust share certificates to their personal broker. Pp. 2-6 above. That is how Petitioners came to acquire the trusts' shares, triggering Section 16(b). The district court found that all of these transactions were voluntary, personally benefited Petitioners, and would not have happened without Petitioners' actions. It further found that Petitioners' voluntary transactions created the very possibility for speculative abuse that Section 16(b) was meant to prevent. P. 6 above.

These findings of undisputed fact are fatal even at the pleading stage, as the court below implicitly recognized. It expressly relied on the district court's findings, holding that state law barred Petitioners' claim for attorney fees and litigation costs because "the Jains' own actions caused them to run afoul of

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litigation expenses. *In re Cendant Corp. Sec. Litig.*, 139 F. Supp. 2d 585 (D.N.J. 2001); *In re Sunrise Sec. Litig.*, 793 F. Supp. 1306 (E.D. Pa. 1992).

section 16(b)." Pet. A-17. Indeed, under Washington law, Petitioners must demonstrate that they were *liable* for the Section 16(b) claim before they can even state an indemnity claim. *See Gilbert H. Moen Co. v. Island Steel Erectors, Inc.*, 128 Wn.2d 745, 763-64, 912 P.2d 472 (1996) (party seeking indemnity after settlement must prove that it was liable for underlying claim); *United Boatbuilders, Inc. v. Tempo Products Co.*, 1 Wn. App. 177, 181, 459 P.2d 958 (1969) (same). They cite no authority suggesting they can admit liability while denying the central findings that establish that liability.[6] In addition, the district court's findings were necessary to both the liability judgment and the decision to award prejudgment interest as part of the judgment. Pet. A-55 (relying on Petitioners' voluntary participation in transactions to impose prejudgment interest), A-76-81 (relying on Petitioners' voluntary participation and formation of escrow account to find liability). Thus Petitioners are collaterally estopped to deny them, as Respondents JP Morgan and Wilson Sonsini emphasized in the courts below. *See Parklane Hosiery Co., Inc. v. Shore,*

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[6] Respondent Perkins Coie's causation argument in connection with Petitioners' malpractice claim applies equally to Petitioners' indemnity claims against JP Morgan. Petitioners allege that JP Morgan's purported wrongdoing was the cause of the judgment against them in the Section 16(b) Action. However, the Washington Superior Court found that the judgment against Petitioners was in error and would have been reversed by the Ninth Circuit. Therefore, the district court's error and the Ninth Circuit's reversal break the chain of causation between JP Morgan's actions and Petitioners' alleged damages.

439 U.S. 322, 99 S. Ct. 645, 58 L. Ed. 2d 552 (1979); *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation,* 402 U.S. 313, 329, 91 S. Ct. 1434, 28 L. Ed. 2d 788 (1971) (non-party to prior case may assert collateral estoppel against party who lost that case); *Duncan v. Judge*, 43 Wn.2d 836, 843, 264 P.2d 865 (1953) (defendant found jointly responsible with another defendant for accident could not seek indemnity from other defendant on the theory that the other defendant was solely responsible).

In sum, this case does not warrant this Court's review. Only a handful of cases have addressed whether a party forced to disgorge profits under Section 16(b), like Petitioners, can maintain an indemnity action to recover them. Every one holds that they cannot. Petitioners cite no case from a state court of last resort or federal court of appeals, under *any* federal securities law, allowing a state-law indemnity claim on parallel facts. There is nothing to review.

II. THE DECISION BELOW IS CORRECT ON THE MERITS – PETITIONERS' STATE LAW INDEMNITY CLAIMS ARE DIRECTLY CONTRARY TO SECTION 16(b), AND ARE BARRED BY THE SUPREMACY CLAUSE.

The decision below is also correct.

Article VI of the Constitution provides that federal law "shall be the supreme Law of the Land;

. . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. Federal law preempts state law where, *inter alia,* state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" or is "contrary to" federal law. *Geier v. American Honda Motor Co., Inc.*, 529 U.S. 861, 873, 881-82, 120 S. Ct. 1913, 146 L. Ed. 2d 914 (2000) (quoting, in part, *Hines v. Davidowitz,* 312 U.S. 52, 67, 61 S. Ct. 399, 85 L. Ed. 581 (1941)).

A state-law indemnity claim would stand as just such an obstacle, indeed run directly contrary, to Section 16(b). Congress' intent in enacting Section 16(b) was to take the profits out of a class of transactions in which it determined the possibility of abuse of inside information was intolerably high. *Reliance Elec. Co.*, 404 U.S. at 422. To effectuate this purpose, Congress created a hard and fast rule: All profits any insider made as a result of any purchase and sale, or sale and purchase, within a six-month period, must be forfeited.

> The objective standard of Section 16(b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation. This approach maximized the ability of the rule to eradicate speculative abuses by reducing difficulties in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect.

Reliance Elec. Co., 404 U.S. at 422 (quoting *Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971)).

Allowing indemnity for Section 16(b) violations, and thereby permitting insiders to keep the profits from their short-swing sales, would defeat the purpose of Section 16(b), presenting an obstacle to it. That is why every court that has addressed the issue, including the courts below, has denied indemnity claims for Section 16(b) violations. *See* pp. 8-9 above. Indeed, the Court of Appeals reviewed the case law on Section 16(b) indemnity claims and found "[i]t is well settled that an insider found to have violated section 16(b) may not seek indemnification for the ensuing liability. This is to prevent an insider from effectively waiving the requirement that short-swing profits be returned, thus frustrating the policy behind section 16(b)." Pet. A-10 (citing *First Golden Bancorporation*, 942 F.2d at 728-29; *Bunker Ramo-Eltra Corp.*, 639 F. Supp. at 418-19; *Schaffer*, 286 F. Supp. 2d at 283).

As noted above, Petitioners do not, and cannot, cite a single case permitting indemnity for a Section 16(b) violation. Instead, they misleadingly argue that their claims should have been upheld under a standard "allowing claims of indemnification by innocent, or merely negligent, defendants accused of violating the federal securities laws." Pet. 19. But that purported standard does not exist. No appellate court has allowed a defendant accused of violating the securities laws to pursue an indemnity claim. Instead, the courts that have addressed the issue,

including those cited by Petitioners, generally hold that indemnity is not available for any securities law violations. *See, e.g., Eichenholtz*, 52 F.3d at 484 ("We agree with those courts that have held that there is no implied right to seek indemnification under the federal securities laws."); *Baker, Watts*, 876 F.2d at 1105 ("[A] right of action for indemnification would frustrate the statute's goal of encouraging diligence and discouraging negligence in securities transactions."); *King*, 876 F.2d at 1282 n.10 ("It is difficult to see how a right to indemnification for even innocent persons would serve the deterrent function which underlies the statute."); *Stowell v. Ted S. Finkel Inv. Services, Inc.*, 641 F.2d 323, 325 (5th Cir. 1981) ("[I]t may be noted that indemnification tends to frustrate the policy of securities legislation."); *Laventhol*, 637 F.2d at 676 ("[T]he purpose of the Act is regulatory rather than compensatory, and permitting indemnity would undermine the statutory purpose of assuring diligent performance of duty and deterring negligence."); *Riverhead Sav. Bank v. Nat'l Mortgage Equity Corp.*, 893 F.2d 1109, 1116 (9th Cir. 1990) ("Indemnification is not available under federal securities laws.").

Even beyond the general unavailability of indemnity under federal securities laws, the policies behind Section 16(b) make it particularly unsuitable for indemnity claims. Even the Southern District of New York, which Petitioners rely on to argue that indemnity claims have been allowed in some securities fraud actions, *see* Pet. 19, n.2, has noted that

allowing a Section 16(b) violator to pursue an indemnity claim would be contrary to the policies behind Section 16(b):

> The Second Circuit has suggested that indemnity claims under the Act may proceed where the wrong committed by those seeking indemnity is no greater than ordinary negligence. *See Fromer v. Yogel*, 50 F. Supp. 2d 227, 238 n.8 (S.D.N.Y. 1999). However, the Second Circuit has not dealt directly with indemnity claims by parties prosecuted under § 16(b), and as this Court has acknowledged, several other Circuits suggest or hold that indemnity is simply unavailable under the federal securities laws. *See id.* at 238 n.8. **Moreover, the Court is persuaded that allowing indemnification for § 16(b) violations would frustrate the public policy behind the statute because liable parties would not have to return their short-swing profits to the plaintiff issuer.** *See Bunker Ramo-Eltra Corp. v. Fairchild Industries, Inc.*, 639 F. Supp. 409, 418-19 (D. Md. 1986) (finding that indemnification clause in stock purchase agreement did not indemnify defendants against § 16(b) action).

Schaffer, 286 F. Supp. 2d at 283 n.6 (emphasis added).

Petitioners' other cases are off point. For example, *Musick, Peeler & Garrett v. Employers Insurance of Wausau*, 508 U.S. 286, 113 S. Ct. 2085, 124

L. Ed. 2d 194 (1993), allows a defendant in a securities fraud claim under Rule 10b-5 to bring a contribution claim under federal law. Petitioners admittedly cannot state a contribution claim here, however. *See* p. 14 n.4 above. *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 93 S. Ct. 1736, 36 L. Ed. 2d 503 (1973), and *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 96 S. Ct. 508, 46 L. Ed. 2d 464 (1976), did not authorize, or even address, indemnity claims. They construed the scope of liability under Section 16(b). But the scope of Petitioners' liability is not at issue. Petitioners' liability was conclusively established in the underlying Section 16(b) Action; besides, Petitioners cannot state an indemnity claim under Washington law unless they *admit* Section 16(b) liability. P. 16 above.

Petitioners assert that their settlement with InfoSpace fulfilled the purposes of Section 16(b) because their profits (or at least a portion of them) were returned to the issuer. But the effectiveness of Section 16(b) depends on taking away profits from insiders, not on where those forfeited funds go. *See Reliance Elec. Co.*, 404 U.S. at 422 (Congress enacted Section 16(b) to take "profits out of a class of transactions"); *Deephaven Capital Mgmt., LLC*, 2007 WL 101821, at *3 (indemnity claim would undermine purpose of Section 16(b) "by allowing a wrongdoer to recoup its disgorged profits").

Schaffer, *First Golden*, *Deephaven*, and *Bunker Ramo-Eltra* govern this case and the Court of Appeals'

opinion is in accord with these decisions. Pet. A-10-14.

The Court of Appeals was also correct in affirming the dismissal of all of Petitioners' claims as "de facto indemnity claims." Pet. A-16. In *First Golden*, the party seeking indemnity for a Section 16(b) claim also brought other claims, including claims for Section 10(b) liability, controlling person liability and negligent misrepresentation. The *First Golden* court held that the party could not avoid the bar against indemnity claims by disguising its indemnity claim as something else. "[T]o the extent that the remaining third-party claims were in reality just disguised indemnity claims for a section 16(b) violation, it would have been appropriate to dismiss them with prejudice." *First Golden*, 942 F.2d at 731. Similarly, the court in *In re Cendant Corp. Securities Litigation*, was quite clear about what should happen to state-law claims that, like Petitioners' claims here, seek to recover damages related to securities liability: "[T]o the extent claims are 'integrally related' with the securities claims that were settled, they would be held to be preempted by the federal securities laws." 139 F. Supp. 2d at 596. Petitioners' claims here, whether entitled indemnity or something else, all seek the same thing: Recovery of Petitioners' settlement payments and litigation expenses relating to the Section 16(b) Action. Consequently, all of Petitioners' claims seek indemnity, are integrally related with the Section 16(b) Action, and are barred.

Last, the Court of Appeals also held that Petitioners cannot recover attorney fees and litigation costs. Besides being correct under the federal law already discussed, this ruling expressly rests on an adequate and independent state-law ground. The Court of Appeals held that Petitioners cannot meet Washington law's requirements for an indemnity claim because their own actions caused the underlying litigation. Pp. 8-9 above. This state-law holding is not subject to review in this Court. *See Michigan v. Long,* 463 U.S. 1032, 1041, 103 S. Ct. 3469, 77 L. Ed. 2d 1201 (1983).

CONCLUSION

The issue presented by this case is whether corporate insiders required to forfeit profits under Section 16(b) can recover those profits through indemnity claims. The lower courts unanimously hold they cannot. There is also no conflict on the broader question Petitioners try to present, whether federal securities laws generally preempt violators' indemnity claims. The court of appeals and state court of last resort decisions addressing such claims have uniformly held them preempted. The decision below

is correct and agrees with established law. The petition should be denied.

Respectfully submitted,

BINGHAM MCCUTCHEN, LLP
DAVID M. BALABANIAN
Counsel of Record
JOHN D. PERNICK
ROBERT A. BRUNDAGE
NIMA E. SOHI
Three Embarcadero Center
San Francisco, CA 94111
(415) 393-2000

Supreme Court, U.S.
FILED
FEB 6 - 2009
OFFICE OF THE CLERK

No. 08-838

IN THE
SUPREME COURT OF THE UNITED STATES

NAVEEN JAIN AND ANURADHA JAIN,
Petitioners,

v.

J.P. MORGAN SECURITIES, INC.,
WILSON SONSINI GOODRICH & ROSATI, P.C.,
AND PERKINS COIE, LLP,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE COURT OF APPEALS
FOR THE STATE OF WASHINGTON

RESPONDENT WILSON SONSINI GOODRICH & ROSATI, P.C.'S OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

MCNAUL EBEL NAWROT & HELGREN PLLC
ROBERT M. SULKIN
Counsel of Record
GREGORY J. HOLLON
BARBARA H. SCHUKNECHT
600 University Street, Suite 2700
Seattle, WA 98101
(206) 467-1816

Attorneys for Respondents Wilson Sonsini Goodrich & Rosati, P.C.

QUESTIONS PRESENTED

1. Are the Circuit Courts in conflict as to whether a party found to have violated § 16(b) of the Securities & Exchange Act of 1934, 15 U.S.C. § 78p(b), may pursue indemnity claims to recover disgorged profits, when every court to address the question has refused to allow such claims?

2. Are the Circuit Courts in conflict regarding how to determine whether a securities law violator's state common law claim is a disguised or de facto indemnity claim, when each Circuit Court to address the issue has focused on what alleged damages are at issue?

CORPORATE DISCLOSURE STATEMENT

In accordance with SUP. CT. R. 29.6, respondent Wilson Sonsini Goodrich & Rosati, P.C. states that no parent or publicly held company owns ten percent or more of its stock.

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INTRODUCTION

In 2003, the United States District Court, Western District of Washington, ordered Petitioners Naveen and Anuradha Jain to disgorge over $200 million in profits garnered from their "short-swing" insider trading of InfoSpace stock. In so doing, the District Court likely erred, particularly in its damages analysis, but Petitioners Naveen and Anuradha Jain did not allow the Ninth Circuit Court of Appeals to so rule. Instead, they abandoned their appeal and sought indemnity from two law firms, respondents Wilson Sonsini Goodrich & Rosati, P.C. ("Wilson") and Perkins Coie, LLP ("Perkins"), and an investment firm, respondent J. P. Morgan Securities, Inc. ("Morgan"). Applying the well-settled rule barring indemnity for securities law violators, the King County Superior Court for the State of Washington dismissed the indemnity claims. The Jains filed amended complaints that no longer expressly sought indemnity, but still sought damages resulting from the insider trading judgment. The Superior Court dismissed the Jains' complaints with prejudice because the no-indemnity-for-securities-violators rule barred the Jains' de facto claims and, alternatively, because the Jains could not establish proximate cause. The Jains appealed. Relying on the no-indemnity-for-securities-violators rule, the Washington State Court of Appeals affirmed the Superior Court's decision. The Jains petitioned for review by the Washington State Supreme Court, which denied their petition.

The Jains allege that conflicts among the Circuit Courts regarding indemnity for securities law violators warrants certiorari. There are no

conflicts among the Circuit Courts, particularly on the narrow issue presented by this case. For this reason, and because the Jains' claims also fail for lack of proximate cause, respondent Wilson respectfully submits that certiorari is not warranted.

COUNTERSTATEMENT OF THE CASE

I. The District Court's Section 16(b) Rulings

Section 16(b) of the Securities & Exchange Act of 1934, 15 U.S.C. § 78p(b) ("section 16(b)") combats the possibility of unfair trading by requiring insiders who engage in short-swing trading, i.e., buying and selling company stock within a six-month period, to disgorge all resulting profits to the company. Section 16(b) is a strict liability provision that requires profit disgorgement whether or not the corporate insider acted with unlawful intent. The Jains violated section 16(b). They claim they did so unwittingly, but the District Court found otherwise. Thus, the District Court rejected the Jains' claim their section 16(b) violation was not voluntary and therefore not actionable, stating:

> The Jains signed papers allowing transfer of funds from [estate-related trusts]. The Jains caused deposits of trust stock into their personal brokerage accounts by forwarding stock certificates to their personal broker. Mr. Jain promised to place shares of the NJGRAT trust into escrow to fulfill a personal obligation. The fact that the Jains failed to read their brokerage statements, simply signed legal documents without knowing what they were, and mistakenly sent certificates

> to their personal broker does not make their actions involuntary....[T]he Jains participated in the transfers and retained more than a degree of control over the transactions. Without the participation of the Jains, the transfers would not have happened.

Pet. A-76 to A-77. The Court's analysis was consistent with Washington state law charging parties with knowledge of the contents of the documents they sign. *E.g., Skagit State Bank v. Rasmussen,* 109 Wash. 2d 377, 381-82, 745 P.2d 37, 39-40 (1987). In this case, those documents included an initial public offering statement for InfoSpace stock, multiple filings with the United States Securities & Exchange Commission ("SEC"), and documents authorizing the deposit of InfoSpace shares issued to estate-related trusts into the Jains' personal accounts.

The District Court ordered the Jains to disgorge $202,551,696.05 in profits realized from the unlawful stock transactions, plus $44,571,016.92 in prejudgment interest, to InfoSpace. Pet. A-50 to A-58. In calculating the Jains' profit, the District Court assigned a purchase price of zero to the shares at issue, including shares the Jains had acquired through a two-for-one stock split. *Id.*

II. The Jains' Post-Judgment Appeal and Pursuit of Indemnity Claims

The Jains reacted to entry of the section 16(b) judgment by filing a state court declaratory judgment action against Morgan and several other defendants, but not Wilson or Perkins. Morgan and the other defendants removed the Jains' lawsuit.

The District Court remanded the suit to the King County Superior Court for the State of Washington. Pet. A-31 to A-43. Neither Wilson nor Perkins was a party to that order, another fact the Jains omit from their Petition.

The Jains also appealed the District Court's adverse section 16(b) rulings to the Ninth Circuit Court of Appeals. To ensure proper construction of section 16(b), the SEC filed an amicus brief on the Jains' behalf, yet another fact the Jains do not mention. The SEC found fault with both the District Court's application of section 16(b) to the Jains' circumstances and its profit and purchase price analysis. Thus it argued that: (1) the Jains received no profit from the transactions; (2) rather than using a purchase price of zero, the District Court should have assigned a purchase price equal to the market value of InfoSpace stock on the date the Jains acquired the shares; and (3) the Jains' stock acquisitions were subject to a statutory exemption for shares acquired by a stock split. Had the Ninth Circuit accepted the SEC's arguments,[1] the Jains would have fully prevailed on appeal or benefited from a drastically reduced judgment.

Despite enjoying the SEC's support, the Jains abandoned their appeal and entered into a global settlement of the section 16(b) lawsuit and several other pending actions, including InfoSpace's claims

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[1] The Ninth Circuit would have deferred to, or at least given serious consideration to, the SEC's analysis. *E.g., Auer v. Robbins,* 519 U.S. 452, 461-62, 117 S. Ct. 905, 137 L. Ed. 2d 79 (1997); *Chevron, U.S.A., Inc. v. Natural Res. Def. Council,* 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984).

against the Jains and the Jains' claims against various insurers. Among other things, the settlement required the Jains to pay InfoSpace $68 million. For undisclosed reasons, the settling parties allocated all but $3 million of the Jains' $68 million payment to the section 16(b) suit. Perhaps not coincidentally, by then the Jains were pursuing indemnity claims to recover their disgorged section 16(b) profits.

After the District Court remanded their suit against Morgan, the Jains amended their complaint to add Wilson as a defendant and to, for the first time, assert express indemnity claims seeking recovery of their disgorged profits and the attorneys' fees they incurred defending against the section 16(b) action. The Jains also began pursuing a separate lawsuit against Perkins. Once the global settlement ended appeal-related stays of these two actions, the Jains filed another round of amended complaints deleting most defendants and asserting or reasserting their express indemnity causes of action. Wilson, Perkins and Morgan all sought dismissal under the rule that indemnity is not available to securities law violators. The Superior Court granted the motions without prejudice to the Jains' right to amend. The Jains' Petition makes no mention of this series of events.

The Jains responded by filing a second amended complaint against Perkins and a third amended complaint against Wilson and Morgan. Those complaints no longer expressly sought indemnity for the Jains' section 16(b) liability, but did so in fact. Wilson, Perkins and Morgan again moved for dismissal. Wilson's motion emphasized

that the Jains still sought damages resulting from their section 16(b) liability and thus the no-indemnity-for-securities-violators rule barred their de facto indemnity claims. Wilson alternatively argued that if, as the Jains claimed, the District Court erred in finding they violated section 16(b) and they in fact were not securities law violators, then the Jains could not establish that Wilson's alleged acts or omissions proximately caused damage to them. Simply put, Wilson's alleged wrongdoing involved the transactions that gave rise to the Jains' alleged section 16(b) liability, not the Jains' defense of the section 16(b) lawsuit. Accordingly, if as the Jains claimed, they did not violate section 16(b), then Wilson obviously could not have caused them to violate that provision. Wilson also pointed out that under Washington law it was significant to the proximate cause analysis that the Jains abandoned their appeal. *E.g., Paradise Orchards Gen. P'ship v. Fearing,* 122 Wash. App. 507, 94 P.3d 372 (2004); *E.g., Nielson v. Eisenhower & Carlson,* 100 Wash. App. 584, 999 P.2d 42 (2000). The Superior Court agreed with all of Wilson's arguments as well as similar arguments made by Perkins and Morgan. It also found that the Ninth Circuit Court of Appeals would have at least partially reversed the District Court's liability determination and would have rejected its damage calculation. The Superior Court then entered orders dismissing the Jains' complaints with prejudice. Pet. A-19 to A-30.

The Jains appealed and the Washington State Court of Appeals affirmed. As had the Superior Court, the Court of Appeals concluded the Jains were asserting de facto or disguised indemnity

claims and the no-indemnity-for-securities-violators rule therefore barred their lawsuits. Pet. A-3 to A-18. The Washington Supreme Court declined to review that decision. Pet. A-1 to A-2.

REASONS TO DENY THE PETITION FOR CERTIORARI

I. Summary of Reasons for Denying Certiorari

The Jains seek a writ of certiorari based on an assertion that "[t]he Circuits are divided on whether and to what extent the Securities Exchange Act of 1934" bars de facto indemnity claims brought by securities law violators against negligent securities professionals. Pet. 4. The conflicts the Jains try to demonstrate do not exist. Every court to address the question has ruled that section 16(b) violators cannot obtain indemnity from anyone, including negligent securities professionals. Every court that has decided whether indemnity is available to those who violate other strict liability provisions of the securities laws has reached the same conclusion. The Circuit Courts agree that whether a state law claim is in fact a disguised or de facto indemnity claim is determined not by the presence of independent claims or the identity of the defendant, but by whether the injured party can assert damages independent of those resulting from the securities violation. The Washington courts adhered to these rules in disallowing the Jains' claims. No conflict among the circuits exists and this case does not warrant Supreme Court review on that basis.

Recognizing this, the Jains' Petition focuses less on showing a conflict than on trying to persuade

the Court it should allow indemnity to "innocent" securities law violators such as they claim to be. Pet. 15-17. To that end, the Jains claim federal courts treat innocent or negligent securities law violators inconsistently. That is not the case. Every Circuit Court addressing a situation in which the party seeking indemnity violated a law imposing liability for negligent or even innocent conduct has refused to allow indemnity. Courts referencing reckless or intentional conduct when analyzing indemnity claims do so only in the context of securities laws for which liability requires scienter.

The Jains' arguments fail to recognize that the key consideration is whether the indemnity-seeker violated the relevant provision of the securities laws. If he or she did, indemnity is not allowed. As the author of the treatise upon which the Jains rely in their "Circuits Are Split" argument explained (in language the Jains omit from their quote on page 18 of the Petition):

> Despite these discrepancies, most of these cases share a common result: whatever rationale or standard the court uses, it generally denies the claim for indemnification. The reasons for this common outcome are straightforward. In the cases under discussion, the defendants seeking indemnification had been held to have violated provisions of the federal securities laws.

Deborah A. DeMott, *Shareholder Derivative Actions Law & Practice* § 6:43 (2008) (footnote omitted).

Indemnity is particularly inappropriate for those who, like the Jains, are subject to a profit disgorgement remedy. The purpose of disgorgement is not to compensate others, but to force a defendant to give up the amount by which he or she was unjustly enriched. *E.g., SEC v. Commonwealth Chem. Secs., Inc.*, 574 F.2d 90, 102 (2d Cir. 1978). To allow indemnification would render that remedy ineffectual. Indeed, Congress made section 16(b) a strict liability-profit disgorgement provision because the only effective way to curb insider trading is "a flat rule taking the profits out of a class of transactions in which the possibility of abuse was ... intolerably great," and by barring any approach requiring "a judicial search for the will-o'-the wisp of an investor's 'intent'[.]" *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422, 425, 92 S. Ct. 596, 30 L. Ed. 2d 575 (1972).

The rule against indemnity applied here conforms to the SEC's long-standing policy against indemnity. Over twenty-five years ago, the agency adopted rules stating in relevant part that, in the SEC's opinion, "indemnification is against public policy as expressed in the [Securities] Act and is therefore unenforceable." 17 C.F.R. § 229.510 (2008) (47 Fed. Reg. 11401 (Mar. 16, 1982)); *accord* 17 C.F.R. § 230.484 (2008) (47 Fed. Reg. 11448 (Mar. 16, 1982)). With their Petition, the Jains ask the Court to ignore that expression of policy because it can lead to harsh results. The Court should reject that request. Any harshness suffered by the Jains resulted not from application of the no-indemnity rule, but from the District Court's erroneous damage and liability analyses. As the SEC made clear, the

Jains should not have had to disgorge any amount to InfoSpace. But rather than allowing the Ninth Circuit to so rule, the Jains chose to abandon their appeal and pursue long-prohibited express indemnity claims. While that decision had unfortunate results for the Jains, their unique situation does not result from any misapplication of indemnity law or unduly harsh anti-indemnity policy, nor does it demonstrate a conflict among the Circuit Courts.

II. The Court Should Deny Certiorari Because Federal Courts Uniformly Bar Indemnity for Section 16(b) Violators

The Circuit Courts agree that those who violate the securities laws cannot obtain indemnity. *See, e.g., Eichenholtz v. Brennan*, 52 F.3d 478, 483-86 (3d Cir. 1995); *First Golden Bancorporation v. Weiszmann*, 942 F.2d 726, 728-29 (10th Cir. 1991); *King v. Gibbs*, 876 F.2d 1275, 1279-83 (7th Cir. 1989); *Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1108 (4th Cir. 1989); *Laventhol, Krekstein, Horwath & Horwath v. Horwitch*, 637 F.2d 672, 676 (9th Cir. 1980). The Courts do not allow indemnity because (1) the securities laws do not provide a right to indemnification; and (2) to allow that remedy would "undermine the statutory purpose of assuring diligent performance of duty and deterring negligence." *Laventhol, Krekstein*, 637 F.2d at 676; *accord Eichenholtz*, 52 F.3d at 484 ("underlying goal of securities legislation is encouraging diligence and discouraging negligence in securities transactions"); *First Golden*, 942 F.2d at 728-29 (noting Congress's deterrence goal in enacting the 1933 and 1934 securities laws); *Baker*,

Watts, 876 F.2d at 1105 ("a right of action for indemnification would frustrate the [1933 Act's] goal of encouraging diligence and discouraging negligence in securities transactions"); *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1288-89 (2d Cir. 1969) (civil liability under securities laws promotes enforcement and deters negligence, goals that could be thwarted if securities violators were indemnified).

An additional policy concern comes into play when, as here, the party seeking indemnification violated section 16(b). As every federal court to address the issue has recognized, to allow indemnification in a section 16(b) case would render ineffective the prophylactic, profit-stripping remedy created by Congress because it would allow the violator to recover his or her disgorged profits. *First Golden*, 942 F.2d at 728-29 ("the public policy behind section 16(b) renders invalid any attempt by an insider to seek indemnification"); *Deephaven Capital Mgmt., LLC v. Schnell*, 2007 U.S. Dist. LEXIS 1504, 2007 WL 101821, *2-4 (D. Minn. Jan. 8, 2007) (allowing indemnification to a section 16(b) violator would undermine deterrence policy because violator would effectively recoup disgorged profits); *Schaffer ex rel. Lasersight, Inc. v. C.C. Invs., LDC*, 286 F. Supp. 2d 279, 282-83 & n.6 (S.D.N.Y. 2003) (allowing indemnification would frustrate public policy because section 16(b) violators would not have to return short-swing profits); *Bunker Ramo-Eltra Corp. v. Fairchild Indus., Inc.*, 639 F. Supp. 409, 418-19 (D. Md. 1986) (indemnity claim was attempt to retain profits resulting from section 16(b) violation); *see also In re XO Commc'ns, Inc.*, 330 B.R. 394, 441 (S.D.N.Y. 2005) (citing *Schaffer* with

approval). The appeals court in this case reached the same conclusion, holding that "an insider found to have violated section 16(b) may not seek indemnification for the ensuing liability. This is to prevent an insider from effectively waiving the requirement that short-swing profits be returned, thus frustrating the policy behind section 16(b)." *Jain v. J.P. Morgan Secs., Inc.*, 142 Wn. App. 574, 582, 177 P.3d 117, 121 (2008) (Pet. A-10), *review denied*, 164 Wn.2d 1022, 196 P.3d 135 (2008).

The Jains nevertheless imply that the scope of the indemnity bar for section 16(b) violators is unsettled because some courts have limited the bar to situations in which the section 16(b) violator sought indemnity from the entity to which the violator disgorged illicit profits. *See* Pet. 25. That is not the case. No court allows indemnity to 16(b) violators – whether the potential indemnitor is a third party such as an accountant or lawyer, or the stock issuing entity. Thus the *First Golden* court rejected indemnity claims brought by a section 16(b) violator against its financial advisor. 942 F.2d at 728. Similarly, in *Deephaven* (a case the Jains fail to cite) the court disallowed a section 16(b) violator's indemnity claims against its portfolio manager. 2007 WL 101821 at *1; *see also Jain*, 142 Wn. App. at 582, 177 P.3d at 121 (Pet. A-10). In all of these cases, the court recognized that in order to maintain the prophylactic profit-stripping remedy of section 16(b), the no-indemnity rule must be enforced.

The Jains appear to suggest that *Bunker Ramo-Eltra*, *Schaffer*, and *In re XO Communications* applied a more limited anti-indemnification rule,

specifically, one that only bars indemnification by the stock-issuing entity. Pet. 25 n.4. The Jains misconstrue the significance of those cases, as none involved an attempt to obtain indemnity from a third party or even mentioned such a scenario. Moreover, in each of those cases, the court expressly acknowledged that to allow indemnity to a section 16(b) violator would eviscerate the provision's profit-stripping remedy and thus contravene public policy. That concern is not dependent in any way on the identity of the party from whom the section 16(b) violator seeks indemnity.

In *Bunker Ramo-Eltra,* for example, the section 16(b) violator sought to enforce an indemnification clause in a stock purchase agreement. The court concluded it would violate public policy to allow indemnification not because of the identity of the proposed indemnitor, but because "defendants ... are trying to retain profits which resulted from their improper actions which did violate section 16(a) as well as the public policy underlying that section of the Exchange Act." *Bunker Ramo-Eltra,* 639 F. Supp. at 418. In *Schaffer,* the court allowed a section 16(b) action to proceed despite the share-issuing corporation's bankruptcy stay, because the suit could benefit creditors by making insiders "disgorge illicit profits" to the corporation. 286 F. Supp. 2d at 282-83. The *In re XO* court similarly recognized that bankruptcy proceedings have no effect on the profit-stripping remedy of a section 16(b) suit. 330 B.R. at 421, 441.

In short, as this Court has long recognized, removing any chance of retaining illicit profits is the most effective way to curb the evils of insider

trading. *Foremost-McKesson, Inc. v. Provident Secs. Co.*, 423 U.S. 232, 243-44, 251, 96 S. Ct. 508, 46 L. Ed. 2d 464 (1976); *Reliance Elec. Co.*, 404 U.S. at 422. Every court to address the question has concluded that to allow any form of indemnity to a section 16(b) violator would undermine achievement of that important goal. The resultant uniformity of results and certainty of outcome are, by themselves, reason to deny the Jains' Petition for Writ of Certiorari.

III. The Court Should Deny Certiorari Because the Circuit Courts Apply Uniform Legal Standards to Indemnity Claims Brought by Securities Law Violators

A. All Circuit Courts Use a Damages-Based Analysis to Identify De Facto or Disguised Indemnity Claims

Despite the lack of any authority allowing indemnity to those who violate section 16(b), the Jains claim clarification is needed regarding whether section 16(b) violators can seek indemnity from "securities professionals" whose negligence allegedly caused the section 16(b) violation. To that end, the Jains claim the Circuit Courts disagree on the extent to which securities violators can pursue "independent" state law claims to recover the illicit profits they were compelled to disgorge. *See* Pet. i, 4. The Jains' assertions notwithstanding, there is no such disagreement. Rather, the Circuit Courts agree that: (1) the anti-indemnity rule does not bar independent state law claims that do not seek indemnity; and (2) the way to distinguish claims

seeking indemnity from claims that are truly independent is to look at the damages in issue.

The most recent Circuit Court decision to so hold is *In re Heritage Bond Litigation*, 546 F.3d 667 (9th Cir. 2008), a case the Jains do not cite.[2] In *Heritage*, the court considered the extent to which a Private Securities Litigation Reform Act bar order could preclude state law claims. The court held that bar orders cannot preclude independent, non-indemnity or non-contribution state law claims, but must bar state law claims asserting as "the injury ... the non-settling defendant's liability to the plaintiff[.]" 546 F.3d at 679. Claims seeking such damages are de facto or disguised indemnity claims and thus are properly barred. 546 F.3d at 677-80.

The Ninth Circuit relied heavily on *Gerber v. MTC Electronic Technologies Co.*, 329 F.3d 297 (2d Cir. 2003), another case the Jains do not cite. In *Gerber*, the Second Circuit likewise held that bar orders in securities cases can properly extinguish "any claims in which the injury is the nonsettling defendant's liability to the plaintiff." 329 F.3d at 306. As the *Gerber* court succinctly explained: "The issue, in other words, is less one of independent 'claims' than independent 'damages.'" 329 F.3d at 307; *accord Heritage*, 546 F.3d at 679.

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[2] *Heritage* effectively rejects the duty-based disguised indemnity claim analysis described by the District Court in this case and quoted by the Jains in their Petition. Pet. 11-12, A-41. The Jains' reliance on the District Court's remand order is therefore misplaced not only because the District Court's analysis was dicta set forth in an order entered without the benefit of briefing by Wilson or Perkins, but also because it is contrary to Ninth Circuit law.

The Ninth Circuit also cited decisions from the Eleventh Circuit, specifically *AAL High Yield Bond Fund v. Deloitte & Touche LLP*, 361 F.3d 1305 (11th Cir. 2004), and *In re U.S. Oil & Gas Litigation*, 967 F.2d 489 (11th Cir. 1992). The *Heritage* court noted that some courts had interpreted the Eleventh Circuit's earlier decision, *In re U.S. Oil & Gas*, as holding that whether a claim is independent turns on whether it involves different facts. *Heritage*, 546 F.3d at 678. In *AAL*, however, the Eleventh Circuit made clear that the claims at issue in *U.S. Oil & Gas* lacked the requisite independence because they sought damages co-extensive with federal securities law liability, not because they arose from the same set of facts. *AAL*, 361 F.3d at 1312; *see also Heritage*, 546 F.3d at 678-79.

The Tenth Circuit Court Appeals has long used the damages-based analysis more recently employed by the Third, Ninth and Eleventh Circuits to identify disguised indemnity claims. In *First Golden*, the Tenth Circuit analyzed whether the claims at issue were de facto indemnity claims by examining whether the damages sought were measured by the underlying securities liability. 942 F.2d at 731-32. To the extent the claims, however denominated, were in fact "liability over" claims (that is, claims that sought to recover as damages the amount of underlying securities liability), they were appropriately dismissed with prejudice. *Id.*

The Fourth Circuit Court of Appeals is also in accord. In *Baker Watts*, the court held that "[t]o the extent ... plaintiff's pendent state actions are claims for indemnification, they must fail as preempted by federal law [because] Congress has not provided a

right to indemnification in the federal securities laws under any circumstances." 876 F.2d at 1108. The court then indicated that state law claims are indemnity claims when a securities law violator is attempting to shift responsibility for its federal violations onto another. *Id.*

The Washington courts used this approach in concluding that the Jains' state law claims sought de facto indemnification. *See Jain*, 142 Wash. App. at 582-85, 177 P.3d at 121-23 (Pet. A-10 to A-14). Citing *First Golden*, the Washington State Court of Appeals thus held that "to whatever extent funds recovered under a state tort claim are comparable to the funds disgorged under section 16(b), they must be barred as de facto indemnification." *Jain*, 142 Wash. App. at 585, 177 P.3d at 123 (Pet. A-14). Because the Jains' state law claims sought such damages, they were barred. 142 Wash. App. at 586-87, 177 P.3d at 123 (Pet. A-16). In so holding, the Washington Court followed well-settled law governing identification of de facto indemnity claims and committed no error.

In sum, there is no conflict among the Circuit Courts with respect to distinguishing between independent state law claims and de facto indemnity claims. The Circuit Courts agree that the prohibition against indemnity for securities law violators extends to state law claims that are disguised or de facto claims for indemnity, no matter who the defendant or what the name of the claim. The Courts also agree that the way to identify a disguised or de facto indemnity claim is to look at the damages in issue. This consistent approach ensures uniform application of the anti-indemnity

bar and adherence to the profit-stripping remedy of section 16(b). For these reasons, too, the Court should deny the Jains' Petition for Writ of Certiorari.

B. There is No Disagreement Among the Circuit Courts About Whether to Limit the Anti-Indemnity Rule to Intentional or Reckless Violators of the Securities Laws

The Jains also urge the Court to grant certiorari to decide whether the anti-indemnity rule should be limited to cases involving reckless, willful or intentional violations of the securities laws. To that end, the Jains cite several cases that they claim show disagreement among the Circuits about whether innocent or negligent securities law violators should be denied indemnity. Again, the Jains' attempt to show a conflict fails. Put simply, the differences the Jains emphasize stem from whether or not the party seeking indemnity actually violated the securities law provision in issue, not from whether he, she, or it acted with a particular mental state.

To reiterate, every court to address indemnity in the context of a section 16(b) violator has refused to allow indemnity. *See supra* at 10-14. The same is true when violations of other strict liability or negligence-based civil liability provisions of the securities laws are at issue. *Baker, Watts,* for example, involved a partnership found liable under section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(a)(2), for unintentionally making material omissions in an offering memorandum. 876 F.2d at 1102-03. The partnership sought indemnity from a

law firm that assisted with the offering. *Id.* The Fourth Circuit Court of Appeals held that under no circumstances did the partnership have a right to indemnification. *Id.*, 876 F.2d at 1108. Similarly, *Eichenholtz* involved allegations that defendants violated section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, a provision imposing liability for false statements or material omissions in registration statements. 52 F.3d at 480, 483. Section 11, like section 16(b) and section 12(2), has no scienter requirement. Despite claims by the parties seeking indemnity that they were merely negligent and played a "*de minimis*" role in the public offering at issue, the Third Circuit Court of Appeals upheld a bar order precluding indemnity claims. 52 F.3d at 484-85. The Ninth Circuit Court of Appeals has reached the same result in section 11 cases. *Franklin v. Kaypro Corp.*, 884 F.2d 1222, 1232 (9th Cir. 1989).

Ignoring these holdings, the Jains focus on cases in which a Circuit Court mentioned the would-be indemnitee's fraud, willfulness, or other form of scienter, and claim those cases show disagreement among the Circuits about whether the indemnity bar should be limited to cases involving scienter. But the Circuit Court decisions upon which the Jains seemingly rely involved violations of securities laws for which proof of scienter is required, i.e., provisions such as Rule 10b-5, 17 C.F.R. § 240.10b-5 (2008), and section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b). *E.g., King v. Gibbs,* 876 F.2d 1275, 1276 (7th Cir. 1989); *Heizer Corp. v. Ross,* 601 F.2d 330, 331 (7th Cir. 1979); *Globus v. Law Research Serv., Inc.,* 418 F.2d 1275 (2d Cir. 1969).

Since under those provisions there ordinarily is no securities law violation (and thus no bar to indemnity) without proof of fault, the courts necessarily discuss mental state. That they do so in the context of a scienter-based violation does not mean, however, that those courts would allow indemnity to a section 16(b) violator subject to a profit disgorgement remedy – a remedy based on unique policies inapposite to those at issue in *King*, *Heizer*, and *Globus*.

Petitioners also cite district court decisions involving indemnity claims brought by those whose status as a securities law violator has not been adjudicated due to a pre-trial settlement or because the case is in a very early stage. *E.g.*, *Fromer v. Yogel*, 50 F. Supp. 2d 227 (S.D.N.Y. 1999); *Greenwald v. Am. Medcare Corp.*, 666 F. Supp. 489 (S.D.N.Y. 1987); *Arden Way Assocs. v. Boesky*, 664 F. Supp. 863 (S.D.N.Y. 1987). Because those cases do not involve a securities law violator, they are inapposite. In fact, the same district court that issued those decisions has also recognized there is no indemnity for those who, like the Jains, are found to have violated section 16(b). *Schaffer*, 286 F. Supp. 2d at 282-83 & n.6 (citing *First Golden*, 942 F.2d at 729).

C. The Court Should Deny Certiorari Because the Jains Seek a Change in the Law That Would Contravene Public Policy

The final section of the Jains' petition urges the Court to abandon the profit-stripping remedy of section 16(b) so that those found to have violated the

provision can recover their disgorged illicit profits from others. The Jains cite no authority supporting that request, nor do they acknowledge that allowing indemnity to section 16(b) violators would eviscerate the purpose of that statute: to curb insider trading by removing any chance that illicit profits might be retained. *Foremost-McKesson,* 423 U.S. at 243-44; *Reliance,* 404 U.S. at 422.

There is nothing harsh or unfair about the remedy of disgorgement; it simply forces a defendant to give up the amount by which he or she was unjustly enriched. *SEC v. Commonwealth Chem.,* 574 F.2d at 102. It does not impose damages or deprive the insider of the long-term investment value of his or her stocks, it simply takes away profits the insider had no right to receive. *Id.* While in this case the District Court miscalculated those profits by a substantial margin, the Jains' remedy for that error lay with the Ninth Circuit Court of Appeals. That the Jains instead chose to pursue prohibited indemnity claims is no reason for this Court to set aside well-settled law, contravene the SEC's express anti-indemnity policy, and undermine the purposes and effectiveness of the disgorgement remedy for section 16(b) violators.

Indeed, to grant the Jains the ruling they seek could lead to unintentional and unintended results and lead to a quagmire of fault and intent-based inquiries. For example, under the Jains' approach an unscrupulous insider who knows her planned transactions violate section 16(b) could obtain indemnity from any professional who happens to give mistaken advice about the transactions' legality.

Such a result would strip section 16(b) of its effectiveness.

CONCLUSION

The Jains' Petition for Writ of Certiorari urges the Court to find conflicts where none exist and to abandon an anti-indemnity policy that has held firm for over 25 years. Because the Jains have failed to articulate a basis for granting certiorari, and the relief they seek is contrary to public policy, and for the additional reasons stated herein and in the oppositions filed by Morgan and Perkins, Wilson respectfully asks the Court to deny the Petition.

Respectfully Submitted,

ROBERT M. SULKIN
Counsel of Record
GREGORY J. HOLLON
BARBARA H. SCHUKNECHT
MCNAUL EBEL NAWROT &
HELGREN PLLC
600 University Street, Suite 2700
Seattle, WA 98101
(206) 467-1816

Attorneys for Respondents Wilson Sonsini Goodrich & Rosati, P.C.

No. 08-838

Supreme Court, U.S.
FILED
FEB 6 - 2009
OFFICE OF THE CLERK

IN THE
SUPREME COURT OF THE UNITED STATES

NAVEEN JAIN AND ANURADHA JAIN,
Petitioners,

v.

J.P. MORGAN SECURITIES, INC.,
WILSON SONSINI GOODRICH & ROSATI, P.C.,
AND PERKINS COIE, LLP,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE COURT OF APPEALS
FOR THE STATE OF WASHINGTON

RESPONDENT PERKINS COIE, LLP'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Howard M. Goodfriend
Counsel of Record
Edwards, Sieh, Smith & Goodfriend, P.S.
1109 First Avenue, Suite 500
Seattle, WA 98101
(206) 624-0974

Bradley S. Keller
Keith D. Petrak
Byrnes & Keller LLP
1000 Second Ave., 38th Flr.
Seattle, WA 98104
(206) 622-2000

Attorneys for Respondent Perkins Coie, LLP

RESTATEMENT OF QUESTION PRESENTED

To the extent the Court has jurisdiction to consider the issue framed in the petition given the alternative state law grounds relied upon by the Washington state courts in dismissing petitioners' claims, the question presented is:

Does the federal policy precluding indemnity for potential violations of Section 16(b) of the Federal Securities Act, 15 U.S.C. § 78p(b), bar claims under state law seeking to recover the funds paid to settle liability under Section 16(b)?

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6, respondent Perkins Coie, LLP certifies as follows:

Perkins Coie, LLP, is a Washington limited liability partnership that has no parent company and no person or publicly held corporation owns 10% or more of its stock.

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STATEMENT OF JURISDICTION

Petitioners Naveen and Anuradha Jain ("Jain") sued respondents under Washington law in Washington State Court. Their lawsuit was dismissed on both federal and state grounds. While this Court may have jurisdiction to address the federal issue raised by Jain as to the other respondents,[1] Jain's petition falters on a jurisdictional level with respect to respondent Perkins Coie, LLP ("Perkins").

All of Jain's claims arise under Washington state law, and the Washington courts relied on Washington state law in holding that Jain failed to state a viable theory of recovery against Perkins. The Washington Court of Appeals held that because "Jain's own conduct caused him to be involved in the litigation . . . they may not recover fees or litigation costs" incurred in defending Section 16(b) claims as damages against all respondents. (Pet. A–18) Further, as the state court dismissed Jains' claims against Perkins for failure to establish causation under Washington State law, there are adequate and independent state grounds for the entire judgment in favor of Perkins and any opinion of this Court on the federal question would be purely advisory.

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[1] Perkins incorporates by this reference the oppositions to certiorari submitted by co-respondents J.P. Morgan Securities, Inc. ("Morgan") and Wilson Sonsini Goodrich & Rosati, P.C. ("Wilson"), because the federal question presented by Jain does not warrant further review.

RESTATEMENT OF THE CASE

The question presented arises from state law claims for negligence and equitable indemnity asserted by Jain in Washington State Superior Court. Jain claimed that respondents' breach of professional duties of care resulted in his liability and subsequent settlement of a claim asserted in federal district court under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b).

In litigation in the U.S. District Court for the Western District of Washington ("Section 16(b) litigation"), the District Court found Jain, the CEO and largest shareholder of Infospace, liable as a matter of law under Section 16(b) for $250 million in alleged short swing profits and interest.[2] The District Court ruled on summary judgment that an alleged escrow of InfoSpace stock owned by several Jain family trusts, and the misdeposit of stock owned by tax-shelter trusts created by Jain into Jain's personal brokerage account, were "purchases" of stock for purposes of Section 16(b) because they would not have occurred absent certain acts and omissions on Jain's part:

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[2] Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p(b)) ("Section 16(b)") imposes strict liability on insiders who engage in "short swing" trades of securities because the "possibility of [insider trading] abuse was believed to be intolerably great" with respect to transactions occurring within such close temporal proximity. *See* ***Reliance Elec. Co. v. Emerson Elec. Co.***, 404 U.S. 418, 422 (1972).

> The Jains claim that they were victims of a combination of errors and oversights by others. Nonetheless, without the participation of the Jains, the purchases would not have happened. . . . Although the Jains may not have acted in bad faith, they clearly were not diligent in their transactions with the Trusts.

(Pet. A–55).

The District Court ruled on damages and entered judgment as a matter of law. (Pet. A–58-59) Jain appealed the District Court's summary rulings on liability and damages to the Ninth Circuit, and then paid a small fraction of the total judgment to settle the Section 16(b) litigation while his appeal was pending. Jain sued Perkins, the law firm that defended him in the Section 16(b) litigation, Morgan, the lead underwriters of Infospace's IPO, and Wilson, Morgan's counsel, in Washington state court to recover the portion of the judgment that he paid ("settlement damages"), as well as his attorney fees and other losses related to the Section 16(b) litigation

("non-settlement damages").[3] Jain alleged that all respondents were negligent in connection with the InfoSpace stock transactions and that Perkins committed legal malpractice in defending Jain during the liability phase of the Section 16(b) litigation.

The Washington Superior Court granted the respondents' motions to dismiss on both federal and state grounds. First, it held that Jain's creative nomenclature "failed to alter the nature of the . . . claim as a de facto indemnification claim preempted by federal law." (App.-9) Second, it held that Jain's claims for non-settlement damages were barred under Washington common law.

Under principles of equitable indemnity, characterized by Washington courts as the "ABC Rule," a party involved in litigation may recover legal fees, expenses and any related losses from a third party only when the third party's wrongful acts are the *sole* cause of the litigation. *See, e.g.,* ***Woodley v. Benson & McLaughlin, P.S.***, 79 Wn. App. 242, 247-48, 901 P.2d 1070, 1073 (1995) (Party B's action to

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[3] Jain sued Perkins separately from Morgan and Wilson, but the cases were consolidated after the Morgan claims were remanded to state court following removal to federal district court. Jain quotes extensively from dicta in the District Court's remand order to support his position that federal law does not bar his attempt to recover his Section 16(b) losses under Washington common law. However, he ignores the District Court's holding that "Jains' state law tort claims are not necessarily federal in character" and that "[d]efendants' argument that the Jains' claims are really claims for reimbursement or indemnification barred by federal law is a federal question defense." (Pet. A–43)

recover attorney fees and litigation expenses against Party A is barred if Party A's conduct is not the only cause involving Party B in litigation with Party C, particularly if Party B's conduct contributed to its exposure to Party C in litigation), *rev. denied*, 913 P.2d 816 (1996). In light of Jain's admitted acts and omissions in the underlying transactions, which were extensively discussed by the District Court in holding Jain liable in the Section 16(b) litigation,[4] Jain had no viable claim for recovery of attorney fees, litigation expenses, and other non-settlement damages under Washington law. (App.-10)

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[4]The District Court held:

> The Jains signed papers allowing transfer of funds from the GRATs. The Jains caused deposits of trust stock into their personal brokerage accounts by forwarding stock certificates to their personal broker. Mr. Jain promised to place shares of the NJGRAT trust into escrow to fulfill a personal obligation. The fact that the Jains failed to read their brokerage statements, simply signed legal documents without knowing what they were, and mistakenly sent certificates to their personal broker does not make their actions involuntary. . . . [T]he Jains participated in the transfers and retained more than a degree of control over the transactions. Without the participation of the Jains, the transfers would not have happened.

(Pet. A–76-77)

While this ruling on an issue of Washington law is dispositive of Jain's claims to recover non-settlement damages, the Superior Court's separate causation rulings under state law disposed of *all* remaining claims against Perkins. Applying well established principles of Washington law regarding causation in professional malpractice claims, the Superior Court held that Jain had not – and could not – allege or prove causation on two independent grounds.

The Superior Court summarized Jain's allegations "as a series of claims that Perkins failed to fully develop evidence of errors on that part of others regarding the subject transactions." (App.–14) Causation thus involved a "legal determination of the extent to which . . . matters were argued to [the District Court] and whether further evidence or argument" would have changed the outcome on summary judgment. (App.–13-14) The Superior Court held that the evidence and arguments advanced by Perkins in the District Court were sufficient for the District Court to "unders[tand] and reject[] the evidence and arguments plaintiff[s] contend were not advocated," and "that they were of no consequence." (App.–15)

The Superior Court found the District Court's rulings were "succinctly clear that Jain's theory was that they were the victims of a combination of errors, mistakes and oversights by others." The District Court nonetheless "conclu[ded] that Jain's actions alone, regardless of the other actions, were enough" to hold him liable and that "[i]ssues of the mistakes of others of which Jain claimed he was unaware of or innocent were considered and directly rejected as

irrelevant." (App.–14) The Superior Court noted that the "exact theories plaintiff contends Perkins failed to advance" could not establish causation because "[t]he fault of others in regard to the transaction at issue is not a defense to 16(b) liability." (App.–15)

Alternatively, the Superior Court also held that the District Court judgment against Jain was the result of two distinct erroneous legal rulings made by the District Court. After considering the trial and appellate record, the Superior Court held that the Ninth Circuit would have reversed at least two of the District Court's key decisions. First, the record compiled by Perkins on summary judgment "raised at least a fact question whether the escrow was ever created." (App.–17) Second, in calculating damages, the District Court erred in failing to consider an "offsetting obligation to return the shares to the trust or at least impute a purchase price equal to market value at the time of acquisition" that would have reduced or negated any recovery, regardless of liability. (App.–17)

The Washington Supreme Court denied Jain's petition for direct review of the Superior Court's causation ruling. The Washington Court of Appeals affirmed the Superior Court's judgment of dismissal, holding that Jain's claims were de facto claims for indemnification barred under federal law. (Pet. A–16) The Court of Appeals also affirmed the Superior Court's ruling that Jain's claims for non-settlement damages were barred by Washington's "ABC Rule." (Pet. A–16-18) As those rulings were dispositive, the Court of Appeals did not address any of the alternative causation rulings made by the Superior

Court in dismissing Jain's common law claims against Perkins.

Jain sought discretionary review by the Washington Supreme Court of the issues addressed by the Court of Appeals as well as the Superior Court's causation ruling. Once again, the Washington Supreme Court denied review, making the state intermediate appellate court's decision final. (Pet. A–2)

REASONS THE PETITION SHOULD BE DENIED

A. The Washington Court Of Appeals Expressly Relied On State Law In Rejecting Jain's Attempt To Recover His Section 16(b) Fees And Litigation Expenses Under Washington's "ABC Rule."

While respondents Morgan and Wilson demonstrate that the federal question presented by Jain does not warrant review by this Court, Jain's petition fails on a more fundamental level because the Washington Court of Appeals expressly relied upon common law principles of equitable indemnity, or Washington's "ABC Rule," as a basis for affirming the dismissal of Jain's claims for non-settlement damages – all attorney fees and litigation related expenses that Jain incurred as a result of the Section 16(b) litigation in District Court. This Court has consistently refused to review a question of federal law decided by a state court if, as here, "the decision of that court rests on a state law ground that is independent of the federal question and adequate to

support the judgment." ***Coleman v. Thompson***, 501 U.S. 722, 729 (1991).

The Washington Court of Appeals held that, "[i]n addition to being barred as de facto indemnity, the Jains' claims also fail to satisfy the requirements of Washington's 'ABC rule.'" (Pet. A–16) While this aspect of the decision below does not entirely dispose of Jain's claims, the state court's reliance on state law counsels against review by this Court because the state court's causation ruling disposed of Jain's remaining claims against Perkins. As the judgment below rests on alternative state law grounds, this Court should deny the petition.

B. The Decision Of The Washington Superior Court Rejecting Jain's State Law Claims For Lack of Proof of Causation Is An Adequate And Independent Basis To Sustain The Judgment.

The judgment dismissing Jain's claims against Perkins rests on additional independent and alternative state law grounds that the Washington Court of Appeals found unnecessary to address. The Superior Court held, as an alternative basis for dismissal, that Jain was unable to prove the "but/for" causation required of a legal malpractice plaintiff under Washington common law. (App.–12-18) That decision under Washington state law is sufficient to support the judgment in favor of Perkins in its entirety. *See* ***Herb v. Pitcairn***, 324 U.S. 117, 126 (1945) ("our power is to correct wrong judgments, not to revise opinions."); ***Murdock v. City of Memphis***, 20 Wall. 590, 636 (1875) (Court must decide whether

issue of state law can sustain the state court judgment, notwithstanding any alleged error in deciding issue of federal law).

Because the Washington Superior Court held that Jain had no claim as a matter of state law, any decision by this Court that the anti-indemnity policies of Section 16(b) do not bar Jain's state law claims against Perkins would be advisory only. This Court refuses to address an issue of federal law "if the same judgment would be rendered by the state court after we corrected its views of federal laws." ***Herb v. Pitcairn***, 324 U.S. at 126 (1945). "Because this Court has no power to review a state law determination that is sufficient to support the judgment, resolution of any independent federal ground for the decision could not affect the judgment and would therefore be advisory." ***Coleman***, 501 U.S. at 729; *see also* ***Lambrix v. Singletary***, 520 U.S. 518, 523 (1997) ("Since the state-law determination is sufficient to sustain the decree, any opinion of this Court on the federal question would be purely advisory.").

While the Washington Court of Appeals did not need to address the alternative causation rulings of the Superior Court, these alternative grounds, which were largely unchallenged by Jain, would necessarily have to be addressed by the Washington appellate courts before this Court could determine whether "the same judgment would be rendered by the state court after we corrected its views of federal law." ***Herb***, 324 U.S. at 126. Exhaustion of these alternative state law issues in Washington appellate courts would be time consuming and in the end futile, as this Court's precedents demonstrate.

In ***Paschall v. Christie-Stewart***, 414 U.S. 100 (1974), for instance, this Court noted probable jurisdiction to determine whether Oklahoma's tax sale statute comported with procedural due process, only to remand to the Oklahoma Supreme Court to address whether a former mineral deed owners' challenge was nonetheless barred under state law, without deciding the federal issue. The Oklahoma trial court had held the action barred under Oklahoma's statute of limitations, but the state Supreme Court addressed only the federal constitutional question in holding the sale valid. On remand, the Oklahoma Supreme Court rejected petitioner's challenge to the application of the statute of limitations based upon the failure to provide the deed holders notice, holding that the issue had been waived and was not preserved for appellate review. 544 P.2d 505 (Okla. 1974). This Court thus never reached the federal issue, ultimately denying certiorari. ***Paschall,*** 426 U.S. 935 (1976). *See also* ***Kirkpartrick v. Christian Homes of Abiline, Inc.***, 460 U.S. 1074, 1075 (1983) (remanding to the Texas intermediate appellate court to address a "question of state law not passed upon or relied upon below.")

A similar procedural scenario is presented here, where the Superior Court dismissed Jain's claim based on Washington state law that the Washington Court of Appeals did not address because it relied on an alternative federal ground. In order to avoid an advisory opinion, this Court would have to order additional litigation in Washington's appellate courts before Jain could have the slimmest hope of squarely presenting a dispositive federal issue. The

Washington Court of Appeals must first address the Superior Court's causation ruling as an alternative basis for dismissal under state law. Jain's ability to succeed on the causation issue is tenuous at best because the Superior Court's causation ruling was itself based on alternative grounds, any one of which is dispositive.

First, the Superior Court held that Jain could not establish that "but for the malpractice, the trial court results would be better," (App.–12), as required by Washington law. ***Daugert v. Pappas***, 104 Wn.2d 254, 260-63, 704 P.2d 600, 605-06 (1985); *see* ***Geer v. Tonnon***, 137 Wn. App. 838, 844-45, 155 P.3d 163, 166-67 (2007), *rev. denied*, 178 P.3d 1032 (2008); ***Nielson v. Eisenhower & Carlson***, 100 Wn. App. 584, 594-95, 999 P.2d 42, 48, *rev. denied,* 10 P.3d 1071 (2000) (causation decision must be made by trial court as an issue of law based on review of record, where issue decided as a matter of law in underlying action). The Superior Court held that Perkins had advanced and the District Court rejected the "exact theories plaintiff contends Perkins failed to advance" in opposing summary judgment in the Section 16(b) litigation. (App–15) The Superior Court also held that additional evidence or arguments regarding the culpability of Morgan, Wilson or Perkins in the underlying transactions would and could have made no difference to the District Court because "[t]he fault of others in regard to the transaction at issue is not a defense to 16(b) liability." (App–15) Finally, if the District Court erred in granting summary judgment on the record created by Perkins, judicial error, and not the alleged malpractice of Perkins, was the sole proximate cause of Jain's damages. (App.–

16-18) Any one of these Superior Court causation rulings is sufficient to justify affirmance on an adequate and independent state law basis.

Jain's ability to present a justiciable federal issue is further hampered by his procedural defaults in Washington's appellate courts. Jain challenged only the Superior Court's ruling that he could not prove causation because the Ninth Circuit would have reversed critical rulings regarding liability and damages in the Section 16(b) litigation.[5] But the Superior Court found causation lacking for an additional reason – that further evidence and argument regarding the fault of others could not as a matter of law have produced a different outcome on summary judgment. Jain's failure to offer argument on these alternative grounds for dismissal until his

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[5] While this causation ruling arguably involves elements of federal law, the federal issue is "only tangentially relevant to an element of a state tort claim" – the causation element requiring a legal malpractice plaintiff to prove the "suit within the suit." ***Singh v. Duane Morris LLP***, 538 F.3d 334, 337-40 (5th Cir. 2008) (legal malpractice claim alleging counsel failed to introduce relevant evidence in federal trademark litigation did not raise a federal question). Further, because Jain did not challenge the Superior Court's analysis of federal law on appeal, and the Washington Court of Appeals did not address this issue, Jain is now barred from seeking certiorari even were he to attempt to recharacterize the Superior Court's causation ruling as a federal issue. *See* ***Palazzolo v. Rhode Island***, 533 U.S. 606, 631 (2001) (refusing to address issue where "[p]etitioner did not press the argument in the state courts, and the issue was not presented in the petition for certiorari.").

reply brief in the Washington Court of Appeals is a procedural default that, as in ***Paschall***, would preclude this Court from ever addressing the federal question presented. *See* ***Cowiche Canyon Conservancy v. Bosley***, 118 Wn.2d 801, 809, 828 P.2d 549 (1992) (finding waiver of error on appeal under Washington law when appellant failed to raise issue before reply).

In any event, even a decision by the Washington Court of Appeals that reversed the Superior Court's causation ruling would still not render the federal question ripe for review by this Court. Any aggrieved party would have the right to seek discretionary review by the Washington Supreme Court. Jain's federal issue would be squarely presented only were Jain to prevail in reversing the Superior Court's alternative causation rulings upon termination of review by Washington's Supreme Court.

Given the lower court's reliance on a dispositive state law ground for entry of judgment against petitioner, a decision by this Court on the question presented would be advisory only. This Court should deny the petition.

C. Indemnity Is Not Available To Recover Damages Arising From Prohibited Short Swing Trades Under Section 16(b) Of The Securities Act.

Even if the Court could reach the issue given the alternative state law grounds, the question presented by Jain presents no substantial federal issue for review for the reasons stated by respondents

Morgan and Wilson. There is no split amongst the circuits regarding the application of the federal policy precluding indemnification to those alleged to have violated Section 16(b).

The purpose of Section 16(b) is to deter insider trading by absolutely prohibiting purchases and sales by insiders within six months, because the "possibility of [insider trading] abuse was believed to be intolerably great" with respect to transactions occurring within such close temporal proximity. ***Reliance Elec. Co. v. Emerson Elec. Co.***, 404 U.S. 418, 422 (1972). Liability is strict, and determined without regard to negligence or intent. As a result, Jain's potential statutory liability under Section 16(b) is not subject to allocation under Washington's statutory scheme governing allocation of fault among parties. Wash. Rev. St. 4.22.015 (defining "fault" as acts or omissions "that are in any measure negligent or reckless" or which "subject a person to strict tort liability or liability on a product liability claim.")

Liability under Section 16(b) extends only to the insider, and the fault of others is not a defense to Section 16(b) liability. *See* ***Volk v. Zlotoff***, 285 F. Supp. 650 (S.D.N.Y. 1968) (rejecting defense of reliance on counsel). Indemnity claims undermine these policies, regardless whether the party seeking indemnity has fully disgorged all Section 16(b) profits. Allowing a Section 16(b) defendant to pursue claims for indemnity from Section 16(b) liability would create a "fault-based" regime that is contrary to Section 16(b) and the policies it is intended to further.

Section 16(b)'s policies of deterrence are similarly undermined where a Section 16(b) defendant seeks indemnity for a *potential* securities liability. If a Section 16(b) defendant could settle, as did Jain, then recover all settlement sums, fees, and expenses, corporate insiders could negotiate indemnity agreements and abuse their insider status as a matter of course. Thus, a final judicial determination that the person seeking indemnity is a "securities law violator" under Section 16(b) (or any other federal securities law) can not be a condition to preempting a de facto indemnity claim. *See, e.g.* ***First Golden Bancorporation v. Weiszmann***, 942 F.2d 726 (10th Cir. 1991) (defendant settling Section 16(b) claim before trial barred from seeking indemnity); ***Stowell v. Ted S. Finkel Investment Services, Inc.***, 641 F.2d 323 (5th Cir. 1981) (dismissing claim for indemnification by securities defendant under Rule 12(b)(6) prior to defendant being found liable).

The conflict posited by Jain is illusory and the policies behind Section 16(b) fully support the Washington Court of Appeals decision. The judgment below presents no substantial federal issue for review by certiorari.

CONCLUSION

This Court should deny the petition for the reasons stated here and by respondents Morgan and Wilson.

DATED this 4th day of February, 2009.

EDWARDS, SIEH, SMITH
& GOODFRIEND, P.S.

By: /s/ Howard M. Goodfriend
Howard M. Goodfriend
Counsel of Record

BYRNES & KELLER LLP

Bradley S. Keller
Keith D. Petrak

Attorneys for Respondent Perkins Coie, LLP

APPENDIX

RESPONDENT PERKINS COIE, LLP'S APPENDIX TO BRIEF IN OPPOSITION

IN THE SUPERIOR COURT OF WASHINGTON
IN AND FOR KING COUNTY

NAVEEN JAIN and ANURADHA JAIN, husband and wife, and their Marital Community,	No. 03-2-32427-2 SEA (Consolidated with 03-2-34789-2 SEA and 04-2-01655-0 SEA)
Plaintiffs,	
vs.	
JP MORGAN SECURITIES, INC., a Delaware corporation, as successor in interest to Hambrecht & Quist LLC, *et al*,	
Defendants.	
NAVEEN JAIN AND ANURADHA JAIN,	
Plaintiffs,	
v.	
PERKINS COIE LLP,	

TRANSCRIPT OF PROCEEDINGS

Heard before the Honorable Judge Richard A. Jones, at King County Courthouse, 516 Third Avenue, Room E-746, Seattle, Washington

Appearances:

ARTHUR HARRIGAN, JR., TIMOTHY LEYH and LARRY GANGNES, representing the Plaintiffs;

JOHN PERNICK, representing the Defendant JP Morgan Securities, Inc.;

ROBERT SULKIN, representing the Defendant Wilson Sonsini Goodrich & Rosati, P.C.;

KEITH PETRAK, representing the Defendant Perkins Coie LLP.

DATE: May 4, 2006

REPORTED BY: Joanne Leatiota, RPR, CRR CCR# 29906

Seattle, Washington; Thursday, May 4, 2006

MORNING SESSION – 9:16 A.M.

THE COURT: Counsel, we are here for the court's ruling, with this court having previously heard the argument of counsel, read the briefs and taken into consideration the matters now before me.

The court will make its determinations in the same order in which the court addressed the parties for purposes of your argument. In that regard, the first motion will be that of JP Morgan Securities.

The plaintiff filed their third amended complaint, which includes allegations and claims against defendant JP Morgan Securities for negligence, breach of fiduciary duty, equitable apportionment, unjust enrichment, recovery of nonsettlement damages, and equity indemnity.

Defendant JP Morgan has filed a CR 12(b)(6) motion to dismiss. The standard to be applied for such relief requires dismissal if it appears beyond doubt the plaintiff can prove no set of facts consistent with the complaint which would entitle them to relief. Courts are to grant 12(b)(6) motions sparingly, with care. In only unusual circumstances a complaint survives a 12(b)(6) motion if any set of facts could exist that would justify recovery.

The court will address each of the claims' bases for dismissal pursuant to the third amended complaint.

At the last motion to dismiss on the second amended complaint, the court specifically ruled that indemnity is not available for violation of Section 16(b). The legal authority in support of that conclusion was First Golden Bankcorporation and Bunker Ramo-Eltra Corporation and Shaffer.

The third amended complaint of plaintiffs, in essence, is a claim for recovery of amounts they allege

they paid to settle the 16(b) action. The attorney's fees, costs and expenses they allege they incurred as a result of or in connection with the Section 16(b) action, and (c), the other direct, indirect, consequential and special nonsettlement damages incurred or that may incur in connection with the 16(b) suit.

The genesis, in essence, of each of these claims are derived from, associated with or connected to the Jains' Section 16(b) liability. Plaintiffs attempt to distinguish between settlement and nonsettlement damages, alleging the latter as outside the indemnity bar.

The court, having reviewed those claims, concludes, as a matter of law, that these claimed nonsettlement damages are litigation costs incurred as a result of the Section 16(b) action. The plaintiffs have stated no legitimate basis to conclude their attorney's fees and litigation expenses did not arise separately from the Section 16(b) action.

In addition, this court finds persuasive the analysis and argument of Western Community Bank v. Helmer, which the plaintiffs failed to or adequately address in their response or argument to this court.

Moreover, the plaintiffs failed to provide any authority allowing recovery of litigation expenses where the litigant's own acts, independent or not, were a cause in the litigation. As in Helmer, this court concludes that the plaintiffs can recover only if they did nothing to contribute or lead to the litigation.

Even if this court ignores Judge Pechman's findings, the evidence is undisputed that the plaintiffs, one, signed the registration statement with the allegedly erroneous footnote; two, sent the split share certification to JP Morgan instead of the trustee; three, signed the transfer form; and four, made the stock sales which generated the profits they were ordered to forfeit.

In light of the totality of these actions, JP Morgan's acts were not the sole cause of the litigation, and the plaintiff, therefore, cannot state a claim for recovery of litigation expenses.

For the record, the ABC rule does not assist plaintiffs. Dreiling brought the 16(b) action derivative on behalf of InfoSpace. Hence, InfoSpace was, in essence, the plaintiff. Because InfoSpace was involved in all of the transactions that issue in the Section 16(b) action, the Jains cannot meet the requirement of the ABC rule.

Plaintiff's unjust enrichment claim also fails. The restatement of restitution limits recovery to cases where the action of the benefit is consciously tortious. There is no allegation of such, and at best, the plaintiffs concede the acts of JP Morgan were accidental and refer to the misdeposits as essentially an internal filing error. Since plaintiffs have not alleged in the third amended complaint that they paid JP Morgan anything in connection with any of the alleged erroneous transactions, they do not state a claim for unjust enrichment.

Last, the court disagrees that the unjust enrichment claim is time barred. The court will give further explanation as to this ruling in the court's analysis for the Perkins Coie motion.

For all of these reasons, JP Morgan's motion to dismiss the third amended complaint pursuant to the noted authority is granted.

The next motion is that of Wilson Sonsini. The court incorporates by reference, to the extent applicable, the ruling stated in the JP Morgan motion to dismiss in this ruling as well. The third amended complaint specifically seeks the costs and other consideration paid by the Jains, one, to settle the 16(b) suit; two, the attorney fees the Jains incurred in defending the 16(b) suit, and the alleged investment losses associated with the supersedeas bond.

The court concludes, as a matter of law, all of these damages are associated with plaintiff's 16(b) liability and constitute nothing more but a restatement and request for a claim for indemnification.

Second, the Jains' claim for unjust enrichment by Wilson Sonsini equally fails. The plaintiffs did not plead and have asserted no facts that the defendants were enriched at plaintiff's expense. The court would specifically reference Far West Steel as case authority that makes it abundantly clear that proof of such is a necessary element for unjust enrichment.

As to the unjust enrichment claim, plaintiffs allege the legal fees that Wilson Sonsini received while they were representing Hambrecht and Quist and/or InfoSpace. This claim also fails. They have not alleged they paid any of those fees. Hence, absent evidence of unjust enrichment at plaintiff's expense, this claim fails.

On the issue of the collateral estoppel, the reply brief of Wilson Sonsini at page 45, they conclude and state the criteria for collateral estoppel. The thrust of plaintiff's argument against the application of collateral estoppel is premised upon the contention that they were effectively deprived of any defense resulting in an injustice.

The court rejects the argument based upon the analysis of Thompson v. State Department of Licensing at 138 Washington Second 783, and specifically the language of that opinion at pages 795 to 96. Consequently, under Thompson, even if Judge Pechman reached an erroneous result, the Jains are not free to relitigate. To follow Jain's theory would eviscerate the effectiveness of the basic principles of collateral estoppel.

As to plaintiff's case within a case claim, that merely allows the plaintiffs to attempt to assign blame for the adverse 16(b) judgment to their litigation counsel. It does not allow them to replace the adverse 16(b) judgment with a new 16(b) judgment in their favor. Hence, the indemnity bar previously ruled upon equally applies herein.

As to the claim by the Jains that intent is still a relevant factor, that claim fails. This court and Judge Pechman have previously unequivocally ruled that the Jains' lack of intent on the 16(b) is irrelevant. Based upon the authority provided by the parties, it appears the limited authority that considered the issue of intent in this context have concluded that indemnity is unavailable for Section 16(b) violations.

Even if this court were to somehow find intent was relevant on the issue of indemnity, Judge Pechman has already ruled in her findings that the 16(b) violations were voluntary.

As to the unjust enrichment claims, the issue is equally disposed of, as Washington law specifically provides that an unjust enrichment claim is only available where the enrichment is at plaintiff's expense. Since the plaintiff appears to concede they did not pay Wilson Sonsini the legal fees they seek to recover in their unjust enrichment claim, this claim fails as a matter of law. The authority plaintiffs cite to the contrary is not applicable to the facts now before this court. On the investment loss claim, it fails as well and must be dismissed. To the extent the Jains violated Section 16(b), they're not entitled to the $247 million for which judgment was entered against them. They're also precluded by law from the investment income.

For all of the foregoing reasons, Wilson Sonsini's motion to dismiss is granted.

The next motion is that of Perkins Coie's motion to dismiss. There are several different components in the motion to dismiss filed by Perkins Coie, and the court will identify each section and then provide its analysis.

First is the erroneous footnote claim. Perkins Coie has raised a variety of bases in support of its motion to dismiss the second amended complaint. The first pertains to plaintiff's erroneous footnote claim.

On this claim, the court agrees with the defendant Perkins. The second amended complaint, paragraph four, provides that Jains' erroneous footnote claim is based entirely upon Perkins' work on the InfoSpace IPO and not upon the defense of the 16(b) suit. On this claim, Perkins does stand in the same shoes as JP Morgan and Wilson Sonsini. For the reasons stated in the rulings on their motion to dismiss, this court incorporates its findings and rulings herein.

Moreover, this court has previously ruled on the reasons for that ruling, and there are no grounds to overrule or reconsider that ruling. Hence, this court rules that Jains' amendments and second amended complaint failed to alter the nature of the erroneous footnote claim as a de facto indemnification claim preempted by federal law.

Next is Perkins' claim that plaintiffs failed to state a claim to recover litigation fees, expenses and related losses. In reviewing plaintiff's allegations, he presents a variety of causes for his being sued in the 16(b) suit other than Perkins' conduct, which includes InfoSpace, JP Morgan and Wilson Sonsini regarding the escrow claims. Before this court are the admissions and averments regarding Jain's own role in the subject transactions.

Under the theory of equitable indemnification, the liability plaintiff seeks is limited and only available in circumstances where the third party is the sole cause of the first party's involvement in the litigation. Since plaintiff has alleged the conduct of others as one of multiple causes for him being sued, his claim is prohibited.

Next is Jain's unjust enrichment claim. This claim fails as well. The record before this court is void of evidence that the fees related to the IPO came at Jain's expense. The record indicates the fees related to the IPO did not come at Jain's expense; rather, they were paid by InfoSpace.

Absent proof of payment by plaintiff, a critical element of an unjust enrichment claim cannot be met. Hence, defendant Perkins' 12(b)(6) motion on this aspect of their motion is granted.

Perkins also suggests that the alleged wrongful acts in preparing the prospectus occurred in 1998 and early 1999, more than three years before plaintiff filed this suit. Perkins' request for the court to time bar the complaint for exceeding the statute of

limitations is denied when we apply the 12(b)(6) standard to the facts as alleged.

The facts, as pled, raised a fact issue in dispute as to the point at which plaintiff should have discovered the alleged injury. This question, as well as whether plaintiff exercised due diligence in discovering the alleged injury, are ordinarily questions for the trier of fact and improper to rule upon as a matter of law. The court makes this finding, so the record is clear as to the basis for the court's total consideration of Perkins Coie's motion.

Next is the issue of plaintiff's litigation defense claims. Perkins claims the judgmental immunity doctrine bars plaintiff's litigation defense claims. This aspect of Perkins' motion is denied. For purposes of this specific issue, the court has considered plaintiff's allegations of negligence where they provide many allegations of Perkins' claimed negligence.

Under the standards of a 12(b) motion, the factual allegations in the complaint are accepted as true. While speculative, specious claims with no basis cannot be treated with like consideration on this claim, a 12(b)(6) motion would be granted only if it appeared beyond a reasonable doubt that plaintiff could prove no facts consistent with the complaint that would entitle plaintiff to the relief requested.

While Perkins cites a host of claimed tactical judgments, the representation and argument of counsel are an overstatement of the relief contemplated by the judgmental immunity doctrine.

Plaintiff's claim for relief on this basis is therefore denied.

Perkins also claims that plaintiff's litigation expense claims fail because proximate cause is lacking as a matter of law. The plaintiff and Perkins agree that liability for legal malpractice requires proof of a breach of duty as a proximate cause for damage to the client. Both parties also agree that proximate cause elements require cause in fact and legal causation. Both parties also agree cause in fact refers to the "but for" consequences of an act. Here the "but for" test is whether but for the malpractice, the trial court results would be better.

The plaintiff contends if the issues pled raised fact issues on the issue of causation, then it cannot be resolved on a 12(b) motion. This court disagrees. The issues as raised and pled are issues of law.

As noted in the Eisenhower opinion, questions of negligence and proximate causation are usually questions for the jury. However, the unique characteristics of legal malpractice in the circumstances of the instant case make that general rule inapplicable.

As noted in Eisenhower, the line between questions for the judge and those for the jury in legal malpractice actions has generally been drawn between questions of law and questions of fact.

In the instant case, the plaintiffs settled their litigation that was pending appeal before the Ninth Circuit on the issues of the summary judgment ruling

of Judge Pechman. The proximate cause issues in this require special legal expertise in analyzing Judge Pechman's legal conclusions and, therefore, involve questions of law, which this court resolves as follows.

The first of which is the stipulation. This issue revolves on the express terms of the stipulation. This is an issue of law, that is, whether the escrow and misdeposit transactions were purchases under Section 16(b).

The court finds the stipulation did not waive trial of disputed issues of fact, and the District Court did not construe it as such, particularly in light of the two stipulations before Judge Pechman. The stipulation did not involve any disputed fact issues and, therefore, cannot, as a matter of law, have caused any injury.

Moreover, the plaintiff does not state or allege with clarity any stipulated fact that was controverted, at least not in the second amended complaint.

Plaintiffs suggest the waiver of the jury trial addresses this question. However, no such allegation is in the second amended complaint. Moreover even if it was an issue, the failure to demand a jury did not cause the adverse ruling on liability.

The next general category is the evidence and arguments Jain contends Perkins should have advocated. Resolution of this issue is also one of law, as it involves a legal determination of the extent to which such matters were argued to Judge Pechman

and whether further evidence or argument would have changed her mind.

What is abundantly clear from the record and Judge Pechman's ruling is that she was succinctly clear that Jain's theory was that they were victims of a combination of errors, mistakes and oversights by others.

My review of the record is that Judge Pechman's ruling was premised upon conclusions that Jain's actions alone, regardless of the other actions, were enough. Judge Pechman's ruling is also abundantly clear that since Jain's transactions were voluntary, he had a liability.

Issues of the mistakes of others of which Jain claimed he was unaware of or innocent were considered and directly rejected as irrelevant. Judge Pechman's analysis concluded that due to Jain's participation in the transfers and retention of more than a degree of control over the transactions, the transfers could not have happened. Hence, liability was premised upon his actions that she deemed voluntary.

The thrust of Jain's litigation defense negligence by defendant Perkins can be summarized as a series of claims that Perkins failed to fully develop evidence of errors on the part of others regarding the subject transactions.

This court concludes, as a matter of law, that the exact theories plaintiff contends Perkins failed to advance do not satisfy the requirement for causation under the proximate cause component of negligence. The fault of others in regard to the transaction at issue is not a defense to 16(b) liability.

This point is driven home when one considers the analysis of such liability considering cases such as Volk v. Zlotoff, 285 F. Supp. 650, from the Southern District of New York, a 1968 opinion where the court held an insider liable even though he was given erroneous advice regarding application of Section 16(b).

The record before this court is clear, Judge Pechman understood and rejected the evidence and arguments plaintiff contend were not advocated. Moreover, the case authority provided by the parties make it clear to this court that such claims are not a defense under Section 16(b).

Judge Pechman's rulings were succinct and pointed and consistent with applicable 16(b) federal law. The fault of others is not a defense to a 16(b) claim. Hence, plaintiff's second amended complaint does not state facts to indicate the necessary element of proximate cause. It is patently obvious that Judge Pechman in the various proceedings considered the thrust and essence of the very claims now advanced by plaintiff, and they were of no consequence. The actions of plaintiff alone was sufficient to cause his liability.

The last issue on causation concerns the outcome of the Ninth Circuit appeal. The most relevant case on this issue is Nielson v. Eisenhower and Carlson at 100 Washington Appellate 584, a 2000 opinion. Following the principles of that case, this court concludes that the "but for" element of proximate cause can be negated as a matter of law, that the outcome on appeal would have left the plaintiff in as good a position as if there had been no negligence.

The instant case had been appealed to the Ninth Circuit to review the rulings of Judge Pechman. What the Ninth Circuit would have ruled is clearly an issue of law that this court is entitled and required to decide.

The court finds that two issues raised by Perkins are dispositive on this issue. The first is the escrow. The essential issue that was critical to finding Jain liable for the escrow purpose was whether the escrow was ever created.

After considering what was before Judge Pechman, this court concludes that the Ninth Circuit would have reversed her granting of Dreiling's motion in regard to the escrow transaction. Dreiling's evidence was extremely limited. He relied upon a limited number of documents filed by InfoSpace with the SEC; two, limited e-mails between Jain and the board in early 2000; three, Ellen Alben testimony of her suspicions; and four, Perkins' physical possession of the NJ GRAT shares in December 1998.

To the contrary, there appears to be evidence that was in existence that the SEC filings were in error and no stock was ever put into escrow. There is also the evidence which is the declarations of InfoSpace officers and directors indicating the absence of any personal knowledge of the stock being placed in escrow and 30(b)(6) evidence of the inability to find evidence that stock was put in escrow. In addition was the evidence that the NJ GRAT stock was in the trust account from January 1999 onward.

This court concludes that the evidence before Judge Pechman raised at least a fact question whether the escrow was ever created. Applying traditional principles of summary judgment, giving all reasonable inferences to the nonmoving party, this court concludes that the Ninth Circuit would have reversed Judge Pechman's ruling that an escrow was created as a matter of law.

The second significant issue the Ninth Circuit would have had to address would have been the issue of damages. The court in its analysis on this issue does give deference to the existence of and nature of arguments advanced by the SEC in its amicus brief where it supported Jain's contentions that the purchase price had to take into account in these circumstances the offsetting obligation to return the shares to the trust or at least impute a purchase price equal to market value at the time of acquisition.

The decisions of Hertzberg v. Dignity Partners, Inc. at 191 F. 3d 1076, a Ninth Circuit decision, 1999, citing Alderman v. SEC, 104 F. 3d 285, and Auer v. Robbins, 519 U.S. 452, 1997, strongly suggests the Ninth Circuit would be obligated or, at a minimum, strongly encouraged to defer to the SEC's interpretation of 16(b) so long as the interpretations were reasonable.

In this regard, the court concludes that the Ninth Circuit would have reversed Judge Pechman on this aspect of her ruling. Having reviewed and ruled that the Ninth Circuit would have reversed Judge Pechman on these two essential issues of escrow and damage, the court finds the allegations of litigation defense claims to be lacking.

Having made the determinations that the Ninth Circuit would have reversed two of the most significant rulings of Judge Pechman, this court finds the outcome of the appeal in Jain's favor would break the chain of causation and proximate cause element. Consequently, Jain would have improved his position on appeal, and the decision to settle, not the alleged negligence of Perkins, was the cause of his injury.

Having made these rulings, the other issues raised need not be addressed. For the foregoing reasons, defendant Perkins Coie's motion pursuant to 12(b)(6) is granted.

Last for the record is the plaintiff's motion for partial summary judgment. The plaintiff has moved for partial summary judgment to, one, strike as a matter of law a defense that plaintiff's litigation

defense claims are preempted as de facto indemnification claims.

The court construes plaintiff's motion as an indirect approach at the 16(b) indemnification prohibition. The essence of plaintiff's argument is that the presumption doctrine only applies if he is actually liable under 16(b) and the District Court's prior dismissal was based upon the District Court's finding that he was liable.

The court reaffirms in this ruling that the fundamental precepts of the securities laws are abundantly clear, and no indemnification for security violations in whatever form are permitted. Consequently, state law claims which seek damages derived from securities violations are preempted as de facto indemnification claims.

A person accused of violating Section 16(b) cannot seek indemnity for that liability or related settlement by claiming it was the issuer's fault or the fault of a third party claimed to have negligently advised him in regard to the transaction.

In addition, the court agrees there are procedural deficiencies to the motion. Plaintiff's motion relies only upon the allegations in the second amended complaint and asks the court to assume they are true. That is the standard for 12(b)(6) motion, not summary judgment. There is no basis for the court to grant summary judgment on affirmative defense based only upon allegations of the complaint.

Last, the plaintiff asks the court to assume facts as true for purposes of a CR 56 motion. The rules for summary judgment construe the facts in favor of the nonmoving party. In light of the inferences that can be drawn from allegations in the second amended complaint and the record before me, the court can find issues demonstrating no duty to plaintiff.

For example, Perkins represented InfoSpace, not Jain, in the IPO and indemnification agreement and that plaintiff's conduct caused the District Court's rulings. For these additional reasons, partial summary judgment motion is denied.

The court also notes that in footnote 64, page 35, defendant Perkins' reply references CR 56(f). The court does not treat this as a motion for continuance, but the court will nonetheless address it.

The court will deny such a request, as there is no affidavit present, there is no outline of the evidence sought, there is no indication how the evidence sought would support their position. Nevertheless, for the foregoing reasons, the motion for partial summary judgment is denied.

Counsel, the court has indicated a series of rulings. The only order that I have was one that was provided by Perkins Coie. That order is insufficient as far as the extent of materials which were before this court for consideration.

So I'd ask if you do not have orders which adequately include all of the matters which are before this court for consideration that you amend or modify. If you have them now, you can show them to opposing counsel, and the court can sign them. Otherwise I will give you a formal date for presentment of the orders.

MR. PETRAK: I have an order.

THE COURT: Counsel, would you show that to counsel.

MR. PERNICK: Just clarification, your Honor, in the order you want a listing of all the pleadings that were considered?

THE COURT: That's correct, counsel.

MR. PETRAK: My order has every pleading and letter that was submitted, but the substance of the order only addresses the motions dealing with Perkins.

THE COURT: Has counsel signed it?

MR. PERNICK: One other clarification, your Honor. Are these now dismissals with prejudice?

THE COURT: Yes, counsel.

MR. SULKIN: Your Honor, it's my understanding plaintiffs have no problem with my order, other than they want to add a reference to your incorporating your oral ruling into this order.

THE COURT: Counsel, I will give you the court's spin on what happens with courts' findings at the trial court level. Traditionally, the Court of Appeals completely ignores what I have to say. The only thing they want to know is if I have affirmed or denied the request.

You will obviously have the opportunity to submit to the Court of Appeals the basis for this court's ruling in the pleadings you would submit for appellate review. However, for purposes of the order, the only thing I am going to sign today is just the order with the specific rulings. You can cross-reference in subsequent pleadings, if that's the parties desire, what the actual rulings of this court have been.

MR. SULKIN: Thank you, your Honor.

MR. PERNICK: Your Honor, JP Morgan will submit an order to the plaintiffs and then submit it to your court either late today or tomorrow.

THE COURT: That's fine, counsel.

MR. SULKIN: Your Honor, we handwrote in a couple of surreply briefs that were filed after this was presented to the court and initialed that.

THE COURT: There is one order that's missing, and that's the one to deny motion for partial summary judgment on behalf of the plaintiffs.

MR. PETRAK: I think I included that in the "plaintiff's motion is denied." I did not include a statement there were questions of fact -- it just said -- the first paragraph of the order say plaintiff's motion is denied.

THE COURT: Counsel, we are in recess. Thank you.

(Proceedings adjourned at 10:54 a.m.)

120 (5)

No. 08-838

Supreme Court, U.S.
FILED
FEB 17 2009
OFFICE OF THE CLERK

In The Supreme Court of the United States

NAVEEN JAIN and ANURADHA JAIN,
Petitioners,

v.

J.P. MORGAN SECURITIES, INC., WILSON SONSINI GOODRICH & ROSATI, P.C., and PERKINS COIE, LLP,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE STATE OF WASHINGTON

REPLY BY NAVEEN AND ANURADHA JAIN IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Arthur W. Harrigan, Jr.
COUNSEL OF RECORD
Timothy G. Leyh
Christopher T. Wion
DANIELSON HARRIGAN LEYH & TOLLEFSON LLP
999 Third Avenue, Suite 4400
Seattle, Washington 98104
Telephone: (206) 623-1700
Facsimile: (206) 623-8717

Robert B. Gould
LAW OFFICES
2110 North Pacific Street, Suite 100
Seattle, Washington 98103
Telephone: (206) 633-4442
Facsimile: (206) 633-4443

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RULES

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I. New Points Raised in Opposition Briefs

The following new points or issues were raised in the Opposition Briefs of Respondent Perkins Coie, LLP ("Perkins"), J. P. Morgan Securities, Inc. ("Morgan") and Wilson Sonsini Goodrich & Rosati, P.C. ("Wilson"), and are addressed here pursuant to Rules of the Supreme Court of the United States, Rule 15-6.

1. Perkins makes the new argument that this Court lacks jurisdiction under the "adequate state grounds" doctrine; *i.e.*, that the state court's judgment can be upheld under state law proximate cause principles. Perkins Brief, pp. 1, 9-14. But the Washington Court of Appeals decided this case only on federal law grounds—the applicability of a federal policy of no "indemnity" for "securities law violators." The Superior Court issued no written ruling on causation, and declined to incorporate its oral comments into the written ruling.

However, the admissions in Respondents' Briefs that the District Court erred in its 16(b) rulings against the Jains—the core of Respondents' proximate cause argument—clearly implicate the conflict in federal law over applying a "no-indemnity" policy to state law claims by innocent or merely negligent plaintiffs against those whose negligence caused their securities liability.

Under *Michigan v. Long*, 463 U.S. 1032 (1983), because the state court decision rests on or, at the very least, is interwoven with questions of federal law, the Court has jurisdiction over this matter.

2. Wilson makes the new argument that federal courts uniformly define allegedly prohibited "de facto indemnity" by evaluating whether the damages claimed overlap with, or consist of, the underlying securities liability. Wilson Brief, pp. 14-18. Wilson does not acknowledge the conflict between the Tenth and Fourth and other Circuits on this issue, and bases its argument largely on inapplicable settlement bar cases (such as *In re Heritage Bond Litigation*, 546 F.3d 667 (9th Cir. 2008)).

3. Morgan makes the new argument that "Petitioners cannot state an indemnity claim under Washington law unless they admit Section 16(b) liability." Morgan Brief, pp. 16, 22. Because the Jains were *held* liable, they are entitled to recover the resulting damages in proportion to the fault of those who caused that judgment. But because Respondents now admit that the federal District Court *erred in its 16(b) holdings* against the Jains, the Court is squarely presented with the issue of whether an anti-indemnity policy should immunize negligent securities professionals from the damage they inflicted on a fault-free or, at most, negligent client. The Jains, who have satisfied any disgorgement requirement of 16(b) even assuming they were actually liable, should be permitted to establish Respondents' responsibility for the entry of a $247 million judgment against them.

II. "Independent and Adequate State Grounds"

Perkins argues that state proximate cause principles are an independent and adequate state law ground to deny the Petition. Perkins Brief, pp. 1, 9-14. The Washington Court of Appeals decision that is the subject of the Jains' Petition, however, does not address those causation issues, nor does any written order of the Superior Court.

In determining the basis on which a judgment rests, the Supreme Court

> seeks answers to two closely related but conceptually different questions: (1) Is the judgment *based upon* a state ground that is independent and free of entanglement with the federal question? (2) Is that state ground adequate to support the judgment? If both questions are answered in the affirmative . . . , the Supreme Court's jurisdiction fails.

Gressman et al., *Supreme Court Practice* at 209 (9th ed. 2007) (hereafter, *Supreme Court Practice*) (citations omitted) (emphasis added).

The independence of an alleged state ground must be "apparent from the four corners of the opinion." *Id.* at 217 (citing to *Michigan v. Long*, 463 U.S. 1032 (1983)).

In *Long*, the Supreme Court established a presumption that is applicable here:

> [W]hen . . . a state court decision fairly appears to rest primarily on federal law, or to be interwoven with federal law, and when the adequacy and independence of any possible state law ground is not clear from the face of the opinion, we will accept as the most reasonable explanation that the state court decided the case the way it did because it believed that federal law required it to do so.

463 U.S. at 1041-42.

The Court of Appeals decision here is not "based on" any state law principle; proximate cause is not even mentioned. In any event, Perkins' remand argument is based on outdated, pre-*Long* case law including *Herb v. Pitcairn*, 324 U.S. 117 (1945). *Long* specifically disapproved of

> [t]he varying practices of (a) vacating and remanding the case to the state court for clarification, or (b) vacating and remanding for such further proceedings as might be appropriate, or (c) continuing the case so that counsel might apply to the state court for amplification, amendment, or certificate that would clarify the basis of the judgment (*Herb v. Pitcairn*, 324 U.S. 117 (1945)); . . . .

Supreme Court Practice, p. 216 (citations omitted).

Perkins also argues that the Jains are not entitled to recover their attorneys' fees and costs under the "ABC rule." Perkins Brief, pp. 8-9. Washington's ABC rule has no bearing on the Jains' claims for their $68 million payment to settle the 16(b) judgment or their $10 million in investment losses incurred to collateralize a supersedeas bond, forestalling greater losses from a fire sale of their assets based on the erroneous 16(b) judgment. The Jains do not seek review of the appellate ruling on their attorneys' fees and costs.

III. Conflicts among Federal Cases Regarding Damage-Based Analysis to Identify "Indemnity" Claims

In its Response Brief, Wilson argues that there is no conflict justifying review because "all Circuit Courts use a damages-based analysis to identify *de facto* or disguised indemnity claims." Wilson Brief, p. 14. Wilson is wrong. It mischaracterizes the Fourth Circuit case, *Baker Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101 (4th Cir. 19898), as a case using "damages-based analysis," and thus overlooks the conflict between *Baker Watts* and *First Golden Bancorporation v. Weiszmann*, 942 F.2d 726 (10th Cir. 1991). Wilson Brief, pp. 16-17.

In fact, the Jains' claims fall squarely within the principle adopted in *Baker, Watts* but rejected by the Tenth Circuit in *First Golden*. In *Baker, Watts*, plaintiff, a "securities wrongdoer,"[1] sued a law firm based on its "independent duty" under state law to

[1] 876 F.2d at 1102.

provide "competent legal representation,"[2] seeking to recover all or part of plaintiff's $1,916,314.17 in securities liability.[3] The Fourth Circuit declined to dismiss this fault-based contribution claim,[4] holding that doing so would "confer an absolute immunity" on the law firm and could "ironically preclude a negligent offender from seeking contribution under state law from an intentional wrongdoer."[5] That the damages sought were all or part of the plaintiff's securities liability was no bar to recovery.

Otherwise, Wilson relies mainly on settlement bar cases, including *Heritage Bond Litigation*, 546 F.3d 667 (9th Cir. 2008), *Gerber v. MTC Electronic Technologies Co.*, 329 F.3d 297 (2d Cir. 2003), and *AAL High Yield Bond Fund v. Deloitte & Touche LLP*, 361 F.3d 1305 (11th Cir. 2004). These cases, to the extent that they are relevant at all, are consistent with the Jains' claims. But they have no bearing on the issue of relevant conflicts among federal courts.

The settlement bar cases *correctly* bar fault-based claims against settling defendants *because* they have paid to settle those claims *and* the non-settling defendant is credited with the full measure of the settling defendants' actual responsibility for the losses. *In re Heritage Bond Litigation*, 546 F.3d at 679 (allowing "disguised claims for contribution

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[2] *Id.* at 1108

[3] *Id.* at 1103.

[4] *Baker, Watts* was decided six years before the United States Congress, in the Private Securities Litigation Reform Act of 1995, codified an express right to contribution. 15 U.S.C. § 78u-4(f)(8).

[5] *Id.* at 1108.

and indemnity" would allow a non-settling defendant to "make an end run around a settlement agreement"). Because any non-settling defendant is credited with the full proportionate fault of the settling defendants—not merely with the amount of the settlement—by definition any claim by the non-settlor for a sum in excess of that credit, based on the non-settlor's securities liability, *must be* for "indemnity": i.e., the non-settlor must be seeking recovery for losses over and above those resulting from the settlors' fault. This rule merely underscores the merit of the Jains' claims, which seek only to allocate damages according to the proportionate fault of negligent securities professionals.

Respondents have paid no part of the Jains' 16(b) liability, and the Jains have received no "credit" against that liability for Respondents' negligence. Rather than presenting "settlement bar" questions, this case presents the classic issue of whether a party who was innocent, or at most negligent (and has discharged its own liability, if any), can recover for losses resulting from securities liability in proportion to the fault of others in creating that liability.

Here, the Jains resolved their liability by a $68 million payment, satisfying the 16(b) "disgorgement" requirement; the 16(b) judgment at most establishes that they were liable without fault; and in fact, as Respondents now admit, they never should have been held liable at all. That the "damages" the Jains seek are the same as their 16(b) liability is no bar to their recovery, to the extent that those damages are the fault of Respondents.

The Jains' claims are not "contribution" claims only because Respondents cannot be liable under 16(b). But for purposes of the "no-indemnity" analysis, they are equivalent. They are fault-based claims that foster diligence on the part of securities professionals and protect clients from their negligence. *See Fromer v. Yogel*, 50 F. Supp.2d 227, 237-38 (S.D.N.Y. 1999) (upholding a fault-based state law claim where the plaintiff was not jointly liable and thus could not seek "contribution"). The New York law claim in *Fromer*[6] is akin to the Jains' Washington law claim;[7] both are based on disproportionate fault—here, between a strictly liable plaintiff and negligent defendants. Because of the absence of joint liability, they are not "contribution" claims, but they serve the very same policies that have led to federal approbation for contribution claims.

Several District Court cases outside the settlement bar context have expressly rejected classifying a fault-based claim as a prohibited *de facto* indemnity claim simply because the damages sought consisted of the plaintiff's securities liability. These decisions presumably reflect the law in the respective Circuits.

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[6] That claim was for "implied-in-law indemnity," applicable when "there is a great disparity in the fault of two tortfeasors, and one of the tortfeasors is held liable for a loss primarily the responsibility of the other." *Fromer*, 50 F. Supp. 2d at 240.

[7] *Sabey v. Howard Johnson*, 101 Wn. App. 575, 5 P.3d 730 (2000) (recognizing "common law indemnity" claims against professional firm by one held liable without fault).

In *In re Cendant*, 139 F. Supp.2d 585 (D.N.J. 2001), the New Jersey District Court rejected the contention that a no-indemnity policy barred state law claims simply because the damages sought were the sum paid in settlement of securities claims:

> [M]erely because Cendant's tort and contract claims seek to recover damages that could be recoverable in a state law indemnity action do[es] not convert these claims into impermissible indemnity claims under the federal securities laws. Rather, they are independent, non-indemnity claims that are neither barred nor preempted by the federal securities laws.

Id. at 596.

The same point was made in *In re Cenco,* 642 F. Supp. 539 (N.D. Ill. 1986), in which an auditor sought to recover as an element of tort (fraud) damages, sums paid in settlement of a securities class action:

> The gist of Seideman's fraud claim is . . . that Cenco has committed a tort on Seidman, and must pay damages for this, damages which happen to encompass the settlement payment. That this element of damage *overlaps* what Seideman maybe could have recovered through indemnity does not *make it* indemnity.

Id. at 542.

The Eastern District of Pennsylvania federal court applied the same principle in *In re Sunrise*, 793 F. Supp. 1306 (E.D. Pa. 1992):

> The damages that the non-settling defendants seek for their tort and contract claims are similar, although not identical, to the damages that they seek for their indemnification claims. *Such an overlap does not necessarily transform the claims into claims for implied indemnity.*

Id. at 1321.

As characterized by Wilson, the Tenth Circuit's decision in *First Golden*—the only Circuit Court 16(b) decision on the no-indemnity issue—conflicts with *Baker v. Watts* and with *In re Sunrise, In re Cenco, In re Cendant* and *Fromer*. Wilson argues that in *First Golden*, the controlling question was "whether the damages sought were measured by the underlying securities liability." Wilson Brief, p. 15. The Tenth Circuit's inquiry was whether a claim was "simply 'liability over' [in contrast to] those claims that ask for independent affirmative relief against the third-party defendants." 942 F.2d at 731. In other words, *First Golden* held that a claim was a prohibited "indemnity" claim because it sought damages consisting of securities liability.

The *First Golden* Court also held that the insider's claim conflicted with 16(b)'s disgorgement policy, but cited only one 16(b) case for this proposition: *Bunker Ramo-Eltra Corp v. Fairchild*

Ind., Inc., 639 F. Supp. 409 (D. Md. 1986).[8] *Bunker-Ramo* correctly held that policy to be inconsistent with *contractual* indemnity *by the issuer*. There is no federal policy reason to bar claims by fault-free or merely negligent insiders against securities professionals whose negligence created the transactions that led to 16(b) liability without the insider's knowledge or authority.

IV. The Jains Are Entitled to Pursue "Indemnity" Claims Because They are Fault-Free, as Respondents Now Admit

The Jains' claims are not for "indemnity": *i.e.*, they do not seek to shift damages to Respondents in excess of Respondents' allocable share of fault in creating the Jains' securities liability. However, even if the label "indemnity" could properly apply to the Jains' claims, such claims should be allowed because the Jains allege that they are fault-free, and Respondents now admit that the Jains were wrongly held to have violated 16(b).

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[8] *Bunker Ramo-Eltra* held that if indemnification were "found to be valid, then the defendants would have been able to waive, in effect, the requirement of section 16(b) since they would not have to return the short-swing profits back to the plaintiff issuer." 630 F. Supp. at 415. This focus on potential indemnification *by the issuer* is also reflected in *Schaffer v. CC Invs., LDC*, 286 F. Supp. 2d 279, 282-83 (S.D.N.Y. 2003), and *In re XO Communications, Inc.*, 330 B.R. 394, 427-30 (S.D.N.Y. 2005) (relying on *Schaffer*). Where, as here, the transactions held to constitute violations of 16(b) resulted from the negligence of securities professionals, and any 16(b) liability has been satisfied by the insider, the principles of *In re Cenco*, *In re Cendant*, and *In re Sunrise* should apply.

Wilson states, for example, that because the District Court erred, "the Jains should not have had to disgorge any amount to InfoSpace." Wilson Brief, pp. 9-10. It also states at 9:

> Any harshness suffered by the Jains resulted . . . from the District Court's erroneous damage and liability analyses.

Perkins argues that the Ninth Circuit would have held that the Jains realized no short-swing profits—*i.e.*, the entire judgment would have been reversed. Perkins Brief, p. 7. *See also* Morgan Brief, p. 16, n.6.

Respondents' admissions confirm that this case must be decided on the basis that the Jains are innocent plaintiffs wrongly held to have violated Section 16(b). The Jains' claims should be treated at least as favorably as claims by those who have not "committed a sin graver than ordinary negligence." *See, Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969); *Greenwald v. American Medcare Corp.*, 666 F. Supp. 489, 493 (S.D.N.Y. 1987) (party "entitled to an opportunity to prove that he was without fault and is therefore entitled to indemnity").

As the *Fromer* court noted, the Seventh Circuit, in *King v. Gibbs*, 876 F.2d 1275 (7th Cir. 1989), apparently would preclude recovery on an "indemnity" claim[9] even by a fault-free plaintiff, but

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[9] The *King* court implicitly recognized fault-based state law claims, which is the correct characterization of the Jains' claims. 876 F.2d at 1279, n. 5. But if the Jains' claims are treated as "indemnity" claims, according to *Fromer*, the Second and Seventh Circuits potentially differ on whether a fault-free

the "Second Circuit has not yet adopted this view." 50 F. Supp. 2d at 238, n. 8. *Fromer* allowed a so-called "indemnity" claim that, under New York law, was based on disproportionate fault ("great disparity in the fault of two tortfeasors," or "implied-in-law indemnity"). 50 F. Supp. at 240. The Jains were held strictly liable--the 16(b) judgment does not establish fault. Under a Washington cause of action called "common law indemnity,"[10] which like the New York claim in *Fromer* is based on disproportionate *fault*, the Jains are entitled to recover in proportion to Respondents' fault.

No federal policy against "indemnity" in favor of "securities law violators" should bar a claim by a fault-free plaintiff held strictly liable because of the negligence of securities professionals.

V. Conclusion

There is no uniform federal policy defining as prohibited "indemnity" any claim to recover damages for securities law liability. There is substantial authority recognizing that holding securities professionals accountable for their negligence is salutary. There is no rational basis for applying a different rule to 16(b) cases, where liability does not even imply fault. Where the insider has satisfied 16(b)'s disgorgement requirement, and alleges innocence, neither the disgorgement nor the deterrence policy of 16(b) is implicated: one cannot

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plaintiff can advance the claim.

[10] The Washington case recognizing this cause of action also involved a plaintiff held strictly liable because of the negligence of a professional firm. *Sabey v. Howard Johnson*, 101 Wn. App. 575, 5 P.3d 730 (2000).

be deterred from being the victim of others' negligence.

DATED this 17th day of February, 2009.

DANIELSON HARRIGAN LEYH & TOLLEFSON LLP

By: /s/ Arthur W. Harrigan, Jr.
Arthur W. Harrigan, Jr.
Counsel of Record
WSBA #1751
Timothy G. Leyh,
WSBA #14853
Christopher T. Wion
WSBA #33207

Robert B. Gould
LAW OFFICES
2110 North Pacific Street, Suite 100
Seattle, Washington 98103

Attorneys for Petitioners Naveen Jain and Anuradha Jain